

SMART FOUNDATION VARIABLE ANNUITY

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

THE PENN MUTUAL LIFE INSURANCE COMPANY

Philadelphia, Pennsylvania 19172 • Telephone (800) 523-0650

INDIVIDUAL VARIABLE AND FIXED ANNUITY CONTRACT

This statement of additional information is not a prospectus. It should be read in conjunction with the current Prospectus dated May 1, 2016 for the individual variable and fixed annuity contract (the “Contract”). The Contract is funded through Penn Mutual Variable Annuity Account III (referred to as the “Separate Account” in the Prospectus and this Statement of Additional Information). To obtain the Prospectus you may write to The Penn Mutual Life Insurance Company (“Penn Mutual” or the “Company”), Customer Service Group, Philadelphia, PA 19172 or visit our web site at www.pennmutual.com or you may call (800) 523-0650. Terms used in this Statement of Additional Information have the same meaning as in the Prospectus.

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VARIABLE SUBACCOUNT INFORMATION

Net Investment Factor

For any Subaccount, the net investment factor for a Valuation Period is determined by dividing (a) by (b) and subtracting (c):

Where (a) is:

The net asset value per share of the mutual fund held in the Subaccount, as of the end of the Valuation Period.

plus

The per share amount of any dividend or capital gain distributions by the mutual fund if the “ex-dividend” date occurs in the Valuation Period.

plus or minus

A per share charge or credit, as we may determine as of the end of the Valuation Period, for provision for taxes (if applicable).

Where (b) is:

The net asset value per share of the mutual fund held in the Subaccount as of the end of the last prior Valuation Period.

plus or minus

The per share charge or credit for provision for taxes as of the end of the last prior Valuation Period (if applicable).

Where (c) is:

The sum of the mortality and expense risk charge and the contract administration charge. On an annual basis, the sum of such charges equals 1.40% for Smart Foundation VA, 1.65% for Smart Foundation Flex VA and 1.60% for Smart Foundation Plus VA of the daily net asset value of the Subaccount.

Valuation Period

Valuation Period is the period from one valuation of underlying fund assets to the next. Valuation is performed each day the New York Stock Exchange is open for trading.

Transaction Valuation

Your assets in the Separate Account are held as Accumulation Units of the Subaccounts that you select. We value Accumulation Units as of the close of regular trading on the New York Stock Exchange (NYSE) (generally, 4:00 p.m. ET). When you invest in, withdraw from or transfer money to a Subaccount, you receive the Accumulation Unit value next computed after we receive and accept your purchase payment or your withdrawal or transfer request at our Administrative Office. Allocation, withdrawal and transfer instructions received at our Administrative Office after the close of regular trading on the NYSE will be valued based on the Accumulation Unit value computed as of the close of regular trading on the next NYSE business day. In order to receive a day’s closing price, instructions sent by facsimile transmission must be received by

our fax server prior to the close of regular trading on that day. Telephone instructions must be received in full, containing all required information and confirmed back to the caller prior to the close of regular trading in order to receive that day's closing price.

ADMINISTRATIVE AND RECORDKEEPING SERVICES

Penn Mutual performs all data processing, recordkeeping and other related services with respect to the Contracts and the Separate Accounts.

DISTRIBUTION OF CONTRACTS

Honor, Townsend & Kent, Inc. ("HTK"), a wholly owned subsidiary of The Penn Mutual Life Insurance Company ("Penn Mutual"), serves as principal underwriter of the Contracts. The address of HTK is 600 Dresher Road, Horsham, PA 19044. For 2013, 2014, and 2015 the Company paid to HTK underwriting commissions of approximately \$1,052,768, \$1,193,444, and \$1,407,127 respectively.

The Contracts will be distributed by HTK through broker-dealers. Total commissions on purchase payments made under the Contract will not exceed 8% and trailer commissions based on a percentage of Contract Value, other allowances and overrides may be paid. The offering of the Contract is continuous, and Penn Mutual does not anticipate discontinuing the offering of the Contract, although we reserve the right to do so.

CUSTODIAN

The Company is custodian of the assets held in the Separate Account.

EXPERTS

The financial statements of the Company as of December 31, 2015 and 2014 and for each of the two years in the period ended December 31, 2015, and the financial statements and financial highlights of the Separate Account of the Company as of December 31, 2015 and for the periods indicated, included in this Statement of Additional Information constituting part of this Registration Statement, have been so included in reliance on the reports of PricewaterhouseCoopers LLP, independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

LEGAL MATTERS

Morgan, Lewis & Bockius LLP has provided advice on certain matters relating to the federal securities laws and the offering of the Contract. Their offices are located at 1111 Pennsylvania Avenue, NW, Washington, D.C. 20004.

FINANCIAL STATEMENTS

The financial statements of the Separate Account and the statutory financial statements of the Company appear on the following pages. The statutory financial statements of the Company should be considered only as bearing upon the Company's ability to meet its obligations under the Contracts.



The Penn Mutual Life Insurance Company
Variable Annuity Account III

Audited Financial Statements
as of December 31, 2015
and for the periods presented



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2001 Market Street,
Philadelphia, PA 19103-7045
T: (267) 330 3000,
F: (267) 330 3300,
www.pwc.com/us

Report of Independent Registered Public Accounting Firm

To the Board of Trustees of The Penn Mutual Life Insurance Company
and Contract Owners of Penn Mutual Variable Annuity Account III
of The Penn Mutual Life Insurance Company

In our opinion, the accompanying statements of assets and liabilities, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of each of the sub accounts constituting Penn Mutual Variable Annuity Account III of The Penn Mutual Life Insurance Company at December 31, 2015, the results of each of their operations for the year then ended, the changes in each of their net assets for each of the two years in the period then ended and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as “financial statements”) are the responsibility of The Penn Mutual Life Insurance Company’s management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of investments by correspondence with the underlying funds’ transfer agents at December 31, 2015, provide a reasonable basis for our opinion.

A handwritten signature in cursive script that reads "PricewaterhouseCoopers USA".

April 1, 2016

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015

| | <u>Total</u> | <u>Money Market Fund</u> | <u>Limited Maturity Bond Fund</u> | <u>Quality Bond Fund</u> |
|--|-------------------------------|------------------------------|---|------------------------------|
| Assets: | | | | |
| Investments at fair value | \$6,023,910,188 | \$74,587,198 | \$93,831,097 | \$259,713,695 |
| Dividends receivable | 637 | 637 | — | — |
| Receivable for securities sold | 8,472,351 | — | — | — |
| Liabilities: | | | | |
| Payable for securities purchased | 8,641,484 | 85,848 | 635,380 | 2,327,972 |
| Total Net Assets | <u>\$6,023,741,692</u> | <u>\$74,501,987</u> | <u>\$93,195,717</u> | <u>\$257,385,723</u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | | \$23,204,355 | \$23,551,960 | \$ 74,636,919 |
| Diversifier II/Optimizer/Retirement Planner VA | | 3,178,666 | 1,949,636 | 10,925,526 |
| Inflation Protector Variable Annuity | | 4,313,506 | 6,067,308 | 22,581,749 |
| Olympia XT Advisor | | — | — | — |
| Penn Freedom Advisor | | — | — | — |
| Pennant Select | | 8,104,037 | 13,387,039 | 29,268,108 |
| PennFreedom | | 15,486,443 | 34,291,450 | 62,937,997 |
| Smart Foundation Flex | | 11,494,170 | 7,146,341 | 26,107,689 |
| Smart Foundation Plus | | 4,397,386 | 3,711,522 | 18,145,279 |
| Smart Foundation VA | | 4,323,424 | 3,090,461 | 12,782,456 |
| Total Net Assets | | <u>\$74,501,987</u> | <u>\$93,195,717</u> | <u>\$257,385,723</u> |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | | \$ 11.07 | \$ 13.30 | \$ 17.75 |
| Diversifier II/Optimizer/Retirement Planner VA | | \$ 22.81 | \$ 16.79 | \$ 40.09 |
| Inflation Protector Variable Annuity | | \$ 9.15 | \$ 9.48 | \$ 10.57 |
| Olympia XT Advisor | | \$ — | \$ — | \$ — |
| Penn Freedom Advisor | | \$ — | \$ — | \$ — |
| Pennant Select | | \$ 11.06 | \$ 13.41 | \$ 17.90 |
| PennFreedom | | \$ 9.84 | \$ 11.72 | \$ 14.88 |
| Smart Foundation Flex | | \$ 9.37 | \$ 9.50 | \$ 9.92 |
| Smart Foundation Plus | | \$ 9.39 | \$ 9.52 | \$ 9.94 |
| Smart Foundation VA | | \$ 9.46 | \$ 9.60 | \$ 10.02 |
| Number of Shares | | 74,501,987 | 8,041,045 | 19,136,485 |
| Cost of Investments | \$4,522,089,119 | \$74,501,987 | \$92,694,249 | \$244,377,554 |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | <u>High Yield Bond Fund</u> | <u>Flexibly Managed Fund</u> | <u>Balanced Fund</u> | <u>Large Growth Stock Fund</u> |
|---|---------------------------------|--------------------------------------|----------------------------|--|
| Assets: | | | | |
| Investments at fair value | \$118,734,252 | \$2,922,120,194 | \$54,367,921 | \$193,405,118 |
| Dividends receivable | — | — | — | — |
| Receivable for securities sold | — | 2,575,587 | — | 1,374,968 |
| Liabilities: | | | | |
| Payable for securities purchased | 1,390,067 | — | 19,732 | — |
| Total Net Assets | <u><u>\$117,344,185</u></u> | <u><u>\$2,924,695,781</u></u> | <u><u>\$54,348,189</u></u> | <u><u>\$194,780,086</u></u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | \$ 34,511,480 | \$ 703,259,790 | \$12,901,729 | \$ 55,026,087 |
| Diversifier II/Optimizer/Retirement Planner VA | 8,920,147 | 175,511,135 | 8,248,626 | 26,814,071 |
| Inflation Protector Variable Annuity | 9,905,836 | 331,940,974 | 4,367,802 | 8,843,852 |
| Olympia XT Advisor | — | — | — | — |
| Penn Freedom Advisor | — | — | — | — |
| Pennant Select | 13,223,363 | 232,851,276 | 7,049,857 | 19,087,616 |
| PennFreedom | 22,244,394 | 603,285,195 | 10,104,903 | 33,663,732 |
| Smart Foundation Flex | 11,107,659 | 397,974,787 | 4,712,138 | 21,647,499 |
| Smart Foundation Plus | 8,979,522 | 274,011,179 | 3,112,202 | 15,613,474 |
| Smart Foundation VA | 8,451,784 | 205,861,445 | 3,850,932 | 14,083,755 |
| Total Net Assets | <u><u>\$117,344,185</u></u> | <u><u>\$2,924,695,781</u></u> | <u><u>\$54,348,189</u></u> | <u><u>\$194,780,086</u></u> |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | \$ 22.28 | \$ 42.71 | \$ 15.25 | \$ 11.84 |
| Diversifier II/Optimizer/Retirement Planner VA* | \$ 79.34 | \$ 258.80 | \$ 15.42 | \$ 81.80 |
| Inflation Protector Variable Annuity | \$ 12.13 | \$ 17.17 | \$ 14.78 | \$ 20.75 |
| Olympia XT Advisor | \$ — | \$ — | \$ — | \$ — |
| Penn Freedom Advisor | \$ — | \$ — | \$ — | \$ — |
| Pennant Select | \$ 22.47 | \$ 43.07 | \$ 15.31 | \$ 11.94 |
| PennFreedom | \$ 21.29 | \$ 30.77 | \$ 15.20 | \$ 16.82 |
| Smart Foundation Flex | \$ 11.29 | \$ 15.29 | \$ 13.21 | \$ 18.19 |
| Smart Foundation Plus | \$ 11.31 | \$ 15.32 | \$ 13.24 | \$ 18.23 |
| Smart Foundation VA | \$ 11.40 | \$ 15.44 | \$ 13.34 | \$ 18.37 |
| Number of Shares | 11,059,772 | 69,552,813 | 3,346,563 | 6,477,555 |
| Cost of Investments | \$109,373,103 | \$1,977,693,631 | \$41,371,480 | \$127,111,415 |

* The accumulated unit value for Diversifier II Non-Qualified in the Large Growth Stock Fund is \$81.13

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | Large Cap Growth Fund | Large Core Growth Fund | Large Cap Value Fund | Large Core Value Fund |
|--|-----------------------------|------------------------------|-------------------------|--------------------------|
| Assets: | | | | |
| Investments at fair value | \$25,998,619 | \$57,414,069 | \$109,953,298 | \$84,928,800 |
| Dividends receivable | — | — | — | — |
| Receivable for securities sold | 53,060 | 271,853 | 362,753 | 498,887 |
| Liabilities: | | | | |
| Payable for securities purchased | — | — | — | — |
| Total Net Assets | \$26,051,679 | \$57,685,922 | \$110,316,051 | \$85,427,687 |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | \$ 8,334,254 | \$11,901,548 | \$ 26,857,616 | \$26,440,343 |
| Diversifier II/Optimizer/Retirement Planner VA | 1,085,380 | 21,330,670 | 28,221,406 | 11,352,804 |
| Inflation Protector Variable Annuity | 1,747,134 | 1,809,547 | 3,434,562 | 3,298,675 |
| Olympia XT Advisor | — | — | — | — |
| Penn Freedom Advisor | — | — | — | — |
| Pennant Select | 2,790,060 | 7,158,066 | 11,775,377 | 10,147,765 |
| PennFreedom | 5,759,767 | 7,797,931 | 21,922,643 | 18,500,679 |
| Smart Foundation Flex | 3,421,693 | 3,403,132 | 6,125,407 | 7,629,078 |
| Smart Foundation Plus | 2,099,199 | 2,772,794 | 7,655,244 | 3,631,375 |
| Smart Foundation VA | 814,192 | 1,512,234 | 4,323,796 | 4,426,968 |
| Total Net Assets | \$26,051,679 | \$57,685,922 | \$110,316,051 | \$85,427,687 |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | \$ 12.77 | \$ 14.75 | \$ 17.44 | \$ 13.46 |
| Diversifier II/Optimizer/Retirement Planner VA | \$ 13.03 | \$ 14.91 | \$ 73.36 | \$ 13.61 |
| Inflation Protector Variable Annuity | \$ 14.80 | \$ 17.99 | \$ 16.00 | \$ 16.09 |
| Olympia XT Advisor | \$ — | \$ — | \$ — | \$ — |
| Penn Freedom Advisor | \$ — | \$ — | \$ — | \$ — |
| Pennant Select | \$ 12.86 | \$ 14.80 | \$ 17.59 | \$ 13.51 |
| PennFreedom | \$ 12.68 | \$ 14.69 | \$ 16.62 | \$ 13.41 |
| Smart Foundation Flex | \$ 13.82 | \$ 16.08 | \$ 14.76 | \$ 15.23 |
| Smart Foundation Plus | \$ 13.85 | \$ 16.12 | \$ 14.79 | \$ 15.26 |
| Smart Foundation VA | \$ 13.96 | \$ 16.24 | \$ 14.91 | \$ 15.38 |
| Number of Shares | 1,990,197 | 3,539,014 | 4,966,954 | 5,783,865 |
| Cost of Investments | \$20,653,636 | \$37,998,047 | \$ 84,804,390 | \$61,013,249 |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | Index 500 Fund | Mid Cap Growth Fund | Mid Cap Value Fund | Mid Core Value Fund |
|--|-----------------------------|----------------------------|-----------------------------|----------------------------|
| Assets: | | | | |
| Investments at fair value | \$244,079,806 | \$70,389,919 | \$105,815,171 | \$41,281,939 |
| Dividends receivable | — | — | — | — |
| Receivable for securities sold | 2,011,171 | — | — | 9,758 |
| Liabilities: | | | | |
| Payable for securities purchased | — | 265,958 | 856,004 | — |
| Total Net Assets | <u>\$246,090,977</u> | <u>\$70,123,961</u> | <u>\$104,959,167</u> | <u>\$41,291,697</u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | \$ 62,539,965 | \$20,921,597 | \$ 31,882,851 | \$13,348,203 |
| Diversifier II/Optimizer/Retirement Planner VA | 18,648,896 | 7,522,536 | 11,133,167 | 1,787,391 |
| Inflation Protector Variable Annuity | 18,067,462 | 2,201,236 | 5,552,315 | 2,755,763 |
| Olympia XT Advisor | — | — | — | — |
| Penn Freedom Advisor | — | — | — | — |
| Pennant Select | 27,601,619 | 7,771,613 | 10,590,910 | 5,512,787 |
| PennFreedom | 65,261,156 | 21,098,016 | 18,238,190 | 9,256,879 |
| Smart Foundation Flex | 25,014,157 | 4,169,837 | 10,196,260 | 3,209,537 |
| Smart Foundation Plus | 14,393,707 | 3,878,536 | 11,823,100 | 3,254,557 |
| Smart Foundation VA | 14,564,015 | 2,560,590 | 5,542,374 | 2,166,580 |
| Total Net Assets | <u>\$246,090,977</u> | <u>\$70,123,961</u> | <u>\$104,959,167</u> | <u>\$41,291,697</u> |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | \$ 17.44 | \$ 11.26 | \$ 29.66 | \$ 21.29 |
| Diversifier II/Optimizer/Retirement Planner VA | \$ 27.53 | \$ 24.68 | \$ 38.81 | \$ 21.73 |
| Inflation Protector Variable Annuity | \$ 18.37 | \$ 15.64 | \$ 16.54 | \$ 17.74 |
| Olympia XT Advisor | \$ — | \$ — | \$ — | \$ — |
| Penn Freedom Advisor | \$ — | \$ — | \$ — | \$ — |
| Pennant Select | \$ 17.59 | \$ 11.35 | \$ 29.91 | \$ 21.44 |
| PennFreedom | \$ 18.91 | \$ 18.12 | \$ 24.80 | \$ 21.15 |
| Smart Foundation Flex | \$ 16.06 | \$ 13.70 | \$ 15.17 | \$ 15.54 |
| Smart Foundation Plus | \$ 16.09 | \$ 13.73 | \$ 15.20 | \$ 15.57 |
| Smart Foundation VA | \$ 16.22 | \$ 13.84 | \$ 15.32 | \$ 15.69 |
| Number of Shares | 15,247,272 | 5,001,709 | 5,421,445 | 2,350,125 |
| Cost of Investments | \$176,257,200 | \$54,585,892 | \$ 79,823,282 | \$29,936,859 |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | SMID Cap Growth Fund | SMID Cap Value Fund | Small Cap Growth Fund | Small Cap Value Fund |
|--|-------------------------------------|------------------------------------|--------------------------------------|-------------------------------------|
| Assets: | | | | |
| Investments at fair value | \$39,884,422 | \$41,345,378 | \$51,125,158 | \$150,116,022 |
| Dividends receivable | — | — | — | — |
| Receivable for securities sold | — | — | — | — |
| Liabilities: | | | | |
| Payable for securities purchased | 166,352 | 271,053 | 170,033 | 292,038 |
| Total Net Assets | <u>\$39,718,070</u> | <u>\$41,074,325</u> | <u>\$50,955,125</u> | <u>\$149,823,984</u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | \$ 6,202,037 | \$ 6,558,320 | \$16,843,407 | \$ 52,569,880 |
| Diversifier II/Optimizer/Retirement Planner VA | 861,458 | 998,264 | 8,830,733 | 14,553,605 |
| Inflation Protector Variable Annuity | 4,462,692 | 6,544,468 | 2,172,733 | 7,375,162 |
| Olympia XT Advisor | — | — | — | — |
| Penn Freedom Advisor | — | — | — | — |
| Pennant Select | 3,078,693 | 2,843,825 | 5,370,950 | 15,537,082 |
| PennFreedom | 11,213,834 | 11,420,898 | 7,896,823 | 30,257,418 |
| Smart Foundation Flex | 7,817,927 | 6,287,535 | 3,609,336 | 11,220,178 |
| Smart Foundation Plus | 3,215,348 | 3,364,141 | 3,760,555 | 11,494,198 |
| Smart Foundation VA | 2,866,081 | 3,056,874 | 2,470,588 | 6,816,461 |
| Total Net Assets | <u>\$39,718,070</u> | <u>\$41,074,325</u> | <u>\$50,955,125</u> | <u>\$149,823,984</u> |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | \$ 17.55 | \$ 17.88 | \$ 19.05 | \$ 38.53 |
| Diversifier II/Optimizer/Retirement Planner VA | \$ 17.75 | \$ 18.08 | \$ 35.83 | \$ 56.82 |
| Inflation Protector Variable Annuity | \$ 17.10 | \$ 16.97 | \$ 14.93 | \$ 17.96 |
| Olympia XT Advisor | \$ — | \$ — | \$ — | \$ — |
| Penn Freedom Advisor | \$ — | \$ — | \$ — | \$ — |
| Pennant Select | \$ 17.62 | \$ 17.95 | \$ 19.21 | \$ 38.86 |
| PennFreedom | \$ 17.49 | \$ 17.82 | \$ 11.64 | \$ 29.96 |
| Smart Foundation Flex | \$ 15.15 | \$ 15.61 | \$ 14.41 | \$ 15.13 |
| Smart Foundation Plus | \$ 15.18 | \$ 15.64 | \$ 14.44 | \$ 15.16 |
| Smart Foundation VA | \$ 15.30 | \$ 15.77 | \$ 14.55 | \$ 15.28 |
| Number of Shares | 2,041,011 | 2,082,877 | 1,782,271 | 5,653,735 |
| Cost of Investments | \$37,966,970 | \$37,324,808 | \$39,763,851 | \$103,044,550 |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | <u>Small Cap Index Fund</u> | <u>Developed International Index Fund</u> | <u>International Equity Fund</u> | <u>Emerging Markets Equity Fund</u> |
|--|-------------------------------------|---|--------------------------------------|---|
| Assets: | | | | |
| Investments at fair value | \$47,564,709 | \$49,965,430 | \$216,943,454 | \$ 93,458,452 |
| Dividends receivable | — | — | — | — |
| Receivable for securities sold | — | — | 495,625 | — |
| Liabilities: | | | | |
| Payable for securities purchased | 71,051 | 166,201 | — | 1,432,427 |
| Total Net Assets | <u><u>\$47,493,658</u></u> | <u><u>\$49,799,229</u></u> | <u><u>\$217,439,079</u></u> | <u><u>\$ 92,026,025</u></u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | \$ 8,239,545 | \$ 8,675,549 | \$ 74,913,122 | \$ 22,916,827 |
| Diversifier II/Optimizer/Retirement Planner VA | 477,381 | 622,877 | 23,343,405 | 4,092,498 |
| Inflation Protector Variable Annuity | 4,960,216 | 5,845,905 | 12,114,324 | 8,215,388 |
| Olympia XT Advisor | — | — | — | — |
| Penn Freedom Advisor | — | — | — | — |
| Pennant Select | 3,921,234 | 5,062,282 | 20,999,465 | 8,843,873 |
| PennFreedom | 15,539,375 | 16,352,742 | 52,232,116 | 31,928,863 |
| Smart Foundation Flex | 7,538,026 | 6,854,348 | 15,974,787 | 8,539,821 |
| Smart Foundation Plus | 2,590,128 | 1,914,952 | 11,437,543 | 3,744,520 |
| Smart Foundation VA | 4,227,753 | 4,470,574 | 6,424,317 | 3,744,235 |
| Total Net Assets | <u><u>\$47,493,658</u></u> | <u><u>\$49,799,229</u></u> | <u><u>\$217,439,079</u></u> | <u><u>\$ 92,026,025</u></u> |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | \$ 15.15 | \$ 10.31 | \$ 20.50 | \$ 8.75 |
| Diversifier II/Optimizer/Retirement Planner VA | \$ 15.32 | \$ 10.42 | \$ 45.75 | \$ 8.85 |
| Inflation Protector Variable Annuity | \$ 16.74 | \$ 11.61 | \$ 13.84 | \$ 8.61 |
| Olympia XT Advisor | \$ — | \$ — | \$ — | \$ — |
| Penn Freedom Advisor | \$ — | \$ — | \$ — | \$ — |
| Pennant Select | \$ 15.21 | \$ 10.35 | \$ 20.67 | \$ 8.78 |
| PennFreedom | \$ 15.10 | \$ 10.27 | \$ 26.07 | \$ 8.72 |
| Smart Foundation Flex | \$ 14.61 | \$ 12.41 | \$ 12.83 | \$ 9.34 |
| Smart Foundation Plus | \$ 14.64 | \$ 12.43 | \$ 12.86 | \$ 9.36 |
| Smart Foundation VA | \$ 14.75 | \$ 12.53 | \$ 12.96 | \$ 9.44 |
| Number of Shares | 2,845,636 | 4,376,031 | 8,973,961 | 9,526,504 |
| Cost of Investments | \$41,792,403 | \$48,197,676 | \$169,291,203 | \$104,092,720 |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | Real Estate Securities Fund | Aggressive Allocation Fund | Moderately Aggressive Allocation Fund | Moderate Allocation Fund |
|--|--|---|--|---|
| Assets: | | | | |
| Investments at fair value | \$101,040,038 | \$58,706,955 | \$229,100,731 | \$331,158,724 |
| Dividends receivable | — | — | — | — |
| Receivable for securities sold | 690,660 | 118,730 | 9,286 | — |
| Liabilities: | | | | |
| Payable for securities purchased | — | — | — | 380,207 |
| Total Net Assets | <u>\$101,730,698</u> | <u>\$58,825,685</u> | <u>\$229,110,017</u> | <u>\$330,778,517</u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | \$ 29,914,931 | \$12,181,174 | \$ 67,745,935 | \$ 69,442,247 |
| Diversifier II/Optimizer/Retirement Planner VA | 4,129,632 | 626,633 | 1,187,842 | 2,728,174 |
| Inflation Protector Variable Annuity | 9,834,948 | 11,321,575 | 29,963,704 | 41,616,231 |
| Olympia XT Advisor | — | — | — | — |
| Penn Freedom Advisor | — | — | — | — |
| Pennant Select | 9,964,101 | 5,214,456 | 26,961,686 | 47,685,347 |
| PennFreedom | 22,899,690 | 10,771,388 | 42,470,912 | 81,196,256 |
| Smart Foundation Flex | 10,399,933 | 7,914,081 | 33,288,595 | 38,888,934 |
| Smart Foundation Plus | 8,056,028 | 2,906,080 | 12,133,649 | 24,757,159 |
| Smart Foundation VA | 6,531,435 | 7,890,298 | 15,357,694 | 24,464,169 |
| Total Net Assets | <u>\$101,730,698</u> | <u>\$58,825,685</u> | <u>\$229,110,017</u> | <u>\$330,778,517</u> |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | \$ 29.00 | \$ 13.64 | \$ 14.31 | \$ 13.27 |
| Diversifier II/Optimizer/Retirement Planner VA | \$ 29.61 | \$ 13.79 | \$ 14.47 | \$ 13.42 |
| Inflation Protector Variable Annuity | \$ 17.34 | \$ 14.83 | \$ 14.21 | \$ 13.27 |
| Olympia XT Advisor | \$ — | \$ — | \$ — | \$ — |
| Penn Freedom Advisor | \$ — | \$ — | \$ — | \$ — |
| Pennant Select | \$ 29.20 | \$ 13.69 | \$ 14.37 | \$ 13.32 |
| PennFreedom | \$ 28.81 | \$ 13.59 | \$ 14.26 | \$ 13.22 |
| Smart Foundation Flex | \$ 15.42 | \$ 13.78 | \$ 13.21 | \$ 12.37 |
| Smart Foundation Plus | \$ 15.45 | \$ 13.81 | \$ 13.24 | \$ 12.39 |
| Smart Foundation VA | \$ 15.57 | \$ 13.92 | \$ 13.35 | \$ 12.49 |
| Number of Shares | 5,368,375 | 3,953,339 | 14,733,763 | 23,034,716 |
| Cost of Investments | \$ 76,506,064 | \$50,092,802 | \$188,205,997 | \$270,365,195 |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | Moderately Conservative Allocation Fund | Conservative Allocation Fund | High Income Bond Fund II† | Financial Services Fund‡ |
|--|--|------------------------------------|---------------------------------|--------------------------------|
| Assets: | | | | |
| Investments at fair value | \$98,361,549 | \$58,189,817 | \$ — | \$ — |
| Dividends receivable | — | — | — | — |
| Receivable for securities sold | — | — | — | — |
| Liabilities: | | | | |
| Payable for securities purchased | 61,746 | 49,415 | — | — |
| Total Net Assets | <u>\$98,299,803</u> | <u>\$58,140,402</u> | <u>\$ —</u> | <u>\$ —</u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | \$25,633,715 | \$15,192,873 | \$ — | \$ — |
| Diversifier II/Optimizer/Retirement Planner VA | 2,064,721 | 270,021 | — | — |
| Inflation Protector Variable Annuity | 11,272,387 | 4,329,052 | — | — |
| Olympia XT Advisor | — | — | — | — |
| Penn Freedom Advisor | — | — | — | — |
| Pennant Select | 14,489,732 | 9,814,170 | — | — |
| PennFreedom | 22,390,601 | 18,821,372 | — | — |
| Smart Foundation Flex | 7,082,503 | 2,730,972 | — | — |
| Smart Foundation Plus | 7,793,244 | 3,433,684 | — | — |
| Smart Foundation VA | 7,572,900 | 3,548,258 | — | — |
| Total Net Assets | <u>\$98,299,803</u> | <u>\$58,140,402</u> | <u>\$ —</u> | <u>\$ —</u> |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | \$ 12.64 | \$ 11.86 | \$ — | \$ — |
| Diversifier II/Optimizer/Retirement Planner VA | \$ 12.78 | \$ 11.99 | \$ — | \$ — |
| Inflation Protector Variable Annuity | \$ 12.29 | \$ 11.16 | \$ — | \$ — |
| Olympia XT Advisor | \$ — | \$ — | \$21.39 | \$10.07 |
| Penn Freedom Advisor | \$ — | \$ — | \$20.82 | \$ 9.80 |
| Pennant Select | \$ 12.68 | \$ 11.90 | \$ — | \$ — |
| PennFreedom | \$ 12.59 | \$ 11.81 | \$ — | \$ — |
| Smart Foundation Flex | \$ 11.57 | \$ 10.68 | \$ — | \$ — |
| Smart Foundation Plus | \$ 11.59 | \$ 10.70 | \$ — | \$ — |
| Smart Foundation VA | \$ 11.68 | \$ 10.79 | \$ — | \$ — |
| Number of Shares | 7,227,927 | 4,567,196 | — | — |
| Cost of Investments | \$87,859,442 | \$55,053,783 | \$ — | \$ — |

† High Income Bond III Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

‡ Financial Services Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | Health Care Fund††† | Russell 2000 1.5x Strategy Fund | Nova Fund†††† | NASDAQ-100 Fund††††† |
|--|---------------------------|---------------------------------------|------------------|-------------------------|
| Assets: | | | | |
| Investments at fair value | \$ — | \$19,010 | \$ — | \$ — |
| Dividends receivable | — | — | — | — |
| Receivable for securities sold | — | 1 | — | — |
| Liabilities: | | | | |
| Payable for securities purchased | — | — | — | — |
| Total Net Assets | <u>\$ —</u> | <u>\$19,011</u> | <u>\$ —</u> | <u>\$ —</u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | \$ — | \$ — | \$ — | \$ — |
| Diversifier II/Optimizer/Retirement Planner VA | — | — | — | — |
| Inflation Protector Variable Annuity | — | — | — | — |
| Olympia XT Advisor | — | — | — | — |
| Penn Freedom Advisor | — | 19,011 | — | — |
| Pennant Select | — | — | — | — |
| PennFreedom | — | — | — | — |
| Smart Foundation Flex | — | — | — | — |
| Smart Foundation Plus | — | — | — | — |
| Smart Foundation VA | — | — | — | — |
| Total Net Assets | <u>\$ —</u> | <u>\$19,011</u> | <u>\$ —</u> | <u>\$ —</u> |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | \$ — | \$ — | \$ — | \$ — |
| Diversifier II/Optimizer/Retirement Planner VA | \$ — | \$ — | \$ — | \$ — |
| Inflation Protector Variable Annuity | \$ — | \$ — | \$ — | \$ — |
| Olympia XT Advisor | \$27.30 | \$ 17.85 | \$18.25 | \$27.43 |
| Penn Freedom Advisor | \$26.56 | \$ 17.37 | \$17.76 | \$26.69 |
| Pennant Select | \$ — | \$ — | \$ — | \$ — |
| PennFreedom | \$ — | \$ — | \$ — | \$ — |
| Smart Foundation Flex | \$ — | \$ — | \$ — | \$ — |
| Smart Foundation Plus | \$ — | \$ — | \$ — | \$ — |
| Smart Foundation VA | \$ — | \$ — | \$ — | \$ — |
| Number of Shares | — | 387 | — | — |
| Cost of Investments | \$ — | \$ 5,605 | \$ — | \$ — |

††† Health Care Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.
†††† Nova Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.
††††† NASDAQ-100 Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | Technology Fund##### | Inverse S&P 500 Strategy Fund##### | Government Long Bond 1.2x Strategy Fund | U.S. Government Money Market Fund |
|--|-------------------------|--|---|---|
| Assets: | | | | |
| Investments at fair value | \$ — | \$ — | \$108,363 | \$4,321 |
| Dividends receivable | — | — | — | — |
| Receivable for securities sold | — | — | 4 | — |
| Liabilities: | | | | |
| Payable for securities purchased | — | — | — | — |
| Total Net Assets | <u>\$ —</u> | <u>\$ —</u> | <u>\$108,367</u> | <u>\$4,321</u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | | |
| Net Assets of Contract owners: | | | | |
| Commander/Enhanced Credit VA | \$ — | \$ — | \$ — | \$ — |
| Diversifier II/Optimizer/Retirement Planner VA | — | — | — | — |
| Inflation Protector Variable Annuity | — | — | — | — |
| Olympia XT Advisor | — | — | 108,367 | — |
| Penn Freedom Advisor | — | — | — | 4,321 |
| Pennant Select | — | — | — | — |
| PennFreedom | — | — | — | — |
| Smart Foundation Flex | — | — | — | — |
| Smart Foundation Plus | — | — | — | — |
| Smart Foundation VA | — | — | — | — |
| Total Net Assets | <u>\$ —</u> | <u>\$ —</u> | <u>\$108,367</u> | <u>\$4,321</u> |
| Accumulation of Unit Values: | | | | |
| Commander/Enhanced Credit VA | \$ — | \$ — | \$ — | \$ — |
| Diversifier II/Optimizer/Retirement Planner VA | \$ — | \$ — | \$ — | \$ — |
| Inflation Protector Variable Annuity | \$ — | \$ — | \$ — | \$ — |
| Olympia XT Advisor | \$17.97 | \$2.32 | \$ 20.48 | \$ 9.25 |
| Penn Freedom Advisor | \$17.48 | \$2.26 | \$ 19.93 | \$ 9.01 |
| Pennant Select | \$ — | \$ — | \$ — | \$ — |
| PennFreedom | \$ — | \$ — | \$ — | \$ — |
| Smart Foundation Flex | \$ — | \$ — | \$ — | \$ — |
| Smart Foundation Plus | \$ — | \$ — | \$ — | \$ — |
| Smart Foundation VA | \$ — | \$ — | \$ — | \$ — |
| Number of Shares | — | — | 3,645 | 4,321 |
| Cost of Investments | \$ — | \$ — | \$112,294 | \$4,321 |

Technology Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

Inverse S&P 500 Strategy Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF ASSETS AND LIABILITIES — DECEMBER 31, 2015
(continued)

| | Utilities Fund##### | Equity Income Portfolio II | International Stock Portfolio |
|--|------------------------|-------------------------------|-------------------------------------|
| Assets: | | | |
| Investments at fair value | \$ — | \$152,672 | \$43,887 |
| Dividends receivable | — | — | — |
| Receivable for securities sold | — | 6 | 2 |
| Liabilities: | | | |
| Payable for securities purchased | — | — | — |
| Total Net Assets | <u>\$ —</u> | <u>\$152,678</u> | <u>\$43,889</u> |
| TOTAL NET ASSETS REPRESENTED BY: | | | |
| Net Assets of Contract owners: | | | |
| Commander/Enhanced Credit VA | \$ — | \$ — | \$ — |
| Diversifier II/Optimizer/Retirement Planner VA | — | — | — |
| Inflation Protector Variable Annuity | — | — | — |
| Olympia XT Advisor | — | 152,678 | 43,889 |
| Penn Freedom Advisor | — | — | — |
| Pennant Select | — | — | — |
| PennFreedom | — | — | — |
| Smart Foundation Flex | — | — | — |
| Smart Foundation Plus | — | — | — |
| Smart Foundation VA | — | — | — |
| Total Net Assets | <u>\$ —</u> | <u>\$152,678</u> | <u>\$43,889</u> |
| Accumulation of Unit Values: | | | |
| Commander/Enhanced Credit VA | \$ — | \$ — | \$ — |
| Diversifier II/Optimizer/Retirement Planner VA | \$ — | \$ — | \$ — |
| Inflation Protector Variable Annuity | \$ — | \$ — | \$ — |
| Olympia XT Advisor | \$17.08 | \$ 16.87 | \$ 15.97 |
| Penn Freedom Advisor | \$16.62 | \$ 16.65 | \$ 15.54 |
| Pennant Select | \$ — | \$ — | \$ — |
| PennFreedom | \$ — | \$ — | \$ — |
| Smart Foundation Flex | \$ — | \$ — | \$ — |
| Smart Foundation Plus | \$ — | \$ — | \$ — |
| Smart Foundation VA | \$ — | \$ — | \$ — |
| Number of Shares | — | 5,712 | 2,992 |
| Cost of Investments | \$ — | \$164,658 | \$48,803 |

Utilities Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III
STATEMENTS OF OPERATIONS — FOR THE YEAR ENDED DECEMBER 31, 2015

| | <u>Total</u> | <u>Money Market Fund</u> | <u>Limited Maturity Bond Fund</u> | <u>Quality Bond Fund</u> | <u>High Yield Bond Fund</u> |
|--|----------------------|------------------------------|---|------------------------------|---------------------------------|
| Net Investment Income (Loss): | | | | | |
| Dividends | \$ 9,690 | \$ 7,253 | \$ — | \$ — | \$ — |
| Expense: | | | | | |
| Mortality and expense risk and administration charges | 80,003,862 | 950,783 | 1,255,396 | 3,467,580 | 1,680,440 |
| Net investment income (loss) | <u>(79,994,172)</u> | <u>(943,530)</u> | <u>(1,255,396)</u> | <u>(3,467,580)</u> | <u>(1,680,440)</u> |
| Net Realized and Unrealized Gains (Losses) on Investments: | | | | | |
| Realized gain (loss) from redemption of fund shares | 246,121,541 | — | 536,816 | 5,125,942 | 5,831,631 |
| Realized gains distributions | 13,898 | — | — | — | — |
| Net realized gain (loss) from investment transactions | 246,135,439 | — | 536,816 | 5,125,942 | 5,831,631 |
| Net change in unrealized gain (loss) of investments | (130,249,179) | — | 251,058 | (4,049,074) | (9,791,500) |
| Net realized and unrealized gain (loss) on investments | <u>115,886,260</u> | <u>—</u> | <u>787,874</u> | <u>1,076,868</u> | <u>(3,959,869)</u> |
| Net increase (decrease) in net assets resulting from operations | <u>\$ 35,892,088</u> | <u>\$(943,530)</u> | <u>\$ (467,522)</u> | <u>\$(2,390,712)</u> | <u>\$(5,640,309)</u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF OPERATIONS — FOR THE YEAR ENDED DECEMBER 31, 2015

(continued)

| | <u>Flexibly Managed Fund</u> | <u>Balanced Fund</u> | <u>Large Growth Stock Fund</u> | <u>Large Cap Growth Fund</u> | <u>Large Core Growth Fund</u> |
|--|--------------------------------------|----------------------------|--|--------------------------------------|---------------------------------------|
| Net Investment Income (Loss): | | | | | |
| Dividends | \$ — | \$ — | \$ — | \$ — | \$ — |
| Expense: | | | | | |
| Mortality and expense risk and administration charges | <u>37,652,224</u> | <u>737,604</u> | <u>2,490,282</u> | <u>343,293</u> | <u>796,244</u> |
| Net investment income (loss) | <u>(37,652,224)</u> | <u>(737,604)</u> | <u>(2,490,282)</u> | <u>(343,293)</u> | <u>(796,244)</u> |
| Net Realized and Unrealized Gains (Losses) on Investments: | | | | | |
| Realized gain (loss) from redemption of fund shares | 85,965,819 | 3,359,324 | 14,649,596 | 1,170,171 | 4,763,795 |
| Realized gains distributions | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| Net realized gain (loss) from investment transactions | 85,965,819 | 3,359,324 | 14,649,596 | 1,170,171 | 4,763,795 |
| Net change in unrealized gain (loss) of investments | <u>48,495,709</u> | <u>(2,976,456)</u> | <u>3,831,379</u> | <u>(1,216,812)</u> | <u>(3,737,860)</u> |
| Net realized and unrealized gain (loss) on investments | <u>134,461,528</u> | <u>382,868</u> | <u>18,480,975</u> | <u>(46,641)</u> | <u>1,025,935</u> |
| Net increase (decrease) in net assets resulting from operations | <u>\$ 96,809,304</u> | <u>\$ (354,736)</u> | <u>\$15,990,693</u> | <u>\$ (389,934)</u> | <u>\$ 229,691</u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF OPERATIONS — FOR THE YEAR ENDED DECEMBER 31, 2015

(continued)

| | Large Cap Value Fund | Large Core Value Fund | Index 500 Fund | Mid Cap Growth Fund | Mid Cap Value Fund |
|--|-------------------------|--------------------------|---------------------|---------------------------|--------------------------|
| Net Investment Income (Loss): | | | | | |
| Dividends | \$ — | \$ — | \$ — | \$ — | \$ — |
| Expense: | | | | | |
| Mortality and expense risk and administration charges | 1,519,974 | 1,173,825 | 3,250,891 | 975,360 | 1,511,177 |
| Net investment income (loss) | <u>(1,519,974)</u> | <u>(1,173,825)</u> | <u>(3,250,891)</u> | <u>(975,360)</u> | <u>(1,511,177)</u> |
| Net Realized and Unrealized Gains (Losses) on Investments: | | | | | |
| Realized gain (loss) from redemption of fund shares | 7,232,365 | 7,346,856 | 18,042,704 | 4,761,062 | 10,470,232 |
| Realized gains distributions | — | — | — | — | — |
| Net realized gain (loss) from investment transactions | 7,232,365 | 7,346,856 | 18,042,704 | 4,761,062 | 10,470,232 |
| Net change in unrealized gain (loss) of investments | (12,285,121) | (8,162,253) | (15,672,125) | (8,945,645) | (19,585,287) |
| Net realized and unrealized gain (loss) on investments | <u>(5,052,756)</u> | <u>(815,397)</u> | <u>2,370,579</u> | <u>(4,184,583)</u> | <u>(9,115,055)</u> |
| Net increase (decrease) in net assets resulting from operations | <u>\$ (6,572,730)</u> | <u>\$ (1,989,222)</u> | <u>\$ (880,312)</u> | <u>\$ (5,159,943)</u> | <u>\$ (10,626,232)</u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF OPERATIONS — FOR THE YEAR ENDED DECEMBER 31, 2015

(continued)

| | Mid Core Value Fund | SMID Cap Growth Fund | SMID Cap Value Fund | Small Cap Growth Fund | Small Cap Value Fund |
|--|------------------------------|------------------------------|------------------------------|-----------------------------|-------------------------------|
| Net Investment Income (Loss): | | | | | |
| Dividends | \$ — | \$ — | \$ — | \$ — | \$ — |
| Expense: | | | | | |
| Mortality and expense risk and administration charges | 600,747 | 540,978 | 582,113 | 691,027 | 2,075,698 |
| Net investment income (loss) | <u>(600,747)</u> | <u>(540,978)</u> | <u>(582,113)</u> | <u>(691,027)</u> | <u>(2,075,698)</u> |
| Net Realized and Unrealized Gains (Losses) on Investments: | | | | | |
| Realized gain (loss) from redemption of fund shares | 6,520,664 | 2,649,277 | 2,147,142 | 3,514,771 | 10,312,265 |
| Realized gains distributions | — | — | — | — | — |
| Net realized gain (loss) from investment transactions | 6,520,664 | 2,649,277 | 2,147,142 | 3,514,771 | 10,312,265 |
| Net change in unrealized gain (loss) of investments | <u>(7,245,051)</u> | <u>(3,559,908)</u> | <u>(4,642,725)</u> | <u>(3,263,014)</u> | <u>(19,043,664)</u> |
| Net realized and unrealized gain (loss) on investments | <u>(724,387)</u> | <u>(910,631)</u> | <u>(2,495,583)</u> | <u>251,757</u> | <u>(8,731,399)</u> |
| Net increase (decrease) in net assets resulting from operations | <u><u>\$ (1,325,134)</u></u> | <u><u>\$ (1,451,609)</u></u> | <u><u>\$ (3,077,696)</u></u> | <u><u>\$ (439,270)</u></u> | <u><u>\$ (10,807,097)</u></u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF OPERATIONS — FOR THE YEAR ENDED DECEMBER 31, 2015

(continued)

| | Small Cap Index Fund | Developed International Index Fund | International Equity Fund | Emerging Markets Equity Fund | Real Estate Securities Fund |
|--|-----------------------------|--|------------------------------|------------------------------------|-----------------------------------|
| Net Investment Income (Loss): | | | | | |
| Dividends | \$ — | \$ — | \$ — | \$ — | \$ — |
| Expense: | | | | | |
| Mortality and expense risk and administration charges | 651,521 | 684,425 | 2,900,316 | 1,344,035 | 1,325,920 |
| Net investment income (loss) | <u>(651,521)</u> | <u>(684,425)</u> | <u>(2,900,316)</u> | <u>(1,344,035)</u> | <u>(1,325,920)</u> |
| Net Realized and Unrealized Gains (Losses) on Investments: | | | | | |
| Realized gain (loss) from redemption of fund shares | 2,122,742 | 1,703,664 | 6,448,969 | 1,048,755 | 8,982,798 |
| Realized gains distributions | — | — | — | — | — |
| Net realized gain (loss) from investment transactions | 2,122,742 | 1,703,664 | 6,448,969 | 1,048,755 | 8,982,798 |
| Net change in unrealized gain (loss) of investments | (4,645,547) | (2,534,781) | 1,283,558 | (12,057,779) | (3,904,964) |
| Net realized and unrealized gain (loss) on investments | <u>(2,522,805)</u> | <u>(831,117)</u> | <u>7,732,527</u> | <u>(11,009,024)</u> | <u>5,077,834</u> |
| Net increase (decrease) in net assets resulting from operations | <u><u>\$(3,174,326)</u></u> | <u><u>\$(1,515,542)</u></u> | <u><u>\$ 4,832,211</u></u> | <u><u>\$(12,353,059)</u></u> | <u><u>\$ 3,751,914</u></u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF OPERATIONS — FOR THE YEAR ENDED DECEMBER 31, 2015

(continued)

| | Aggressive Allocation Fund | Moderately Aggressive Allocation Fund | Moderate Allocation Fund | Moderately Conservative Allocation Fund | Conservative Allocation Fund |
|--|---|--|---|--|---|
| Net Investment Income (Loss): | | | | | |
| Dividends | \$ — | \$ — | \$ — | \$ — | \$ — |
| Expense: | | | | | |
| Mortality and expense risk and administration charges | 832,265 | 3,196,663 | 4,626,346 | 1,366,488 | 775,884 |
| Net investment income (loss) | <u>(832,265)</u> | <u>(3,196,663)</u> | <u>(4,626,346)</u> | <u>(1,366,488)</u> | <u>(775,884)</u> |
| Net Realized and Unrealized Gains (Losses) on Investments: | | | | | |
| Realized gain (loss) from redemption of fund shares | 3,138,802 | 8,954,148 | 13,429,479 | 4,254,299 | 1,629,379 |
| Realized gains distributions | — | — | — | — | — |
| Net realized gain (loss) from investment transactions | 3,138,802 | 8,954,148 | 13,429,479 | 4,254,299 | 1,629,379 |
| Net change in unrealized gain (loss) of investments | <u>(4,124,919)</u> | <u>(11,600,146)</u> | <u>(15,112,345)</u> | <u>(4,395,187)</u> | <u>(1,535,253)</u> |
| Net realized and unrealized gain (loss) on investments | <u>(986,117)</u> | <u>(2,645,998)</u> | <u>(1,682,866)</u> | <u>(140,888)</u> | <u>94,126</u> |
| Net increase (decrease) in net assets resulting from operations | <u>\$(1,818,382)</u> | <u>\$(5,842,661)</u> | <u>\$(6,309,212)</u> | <u>\$(1,507,376)</u> | <u>\$(681,758)</u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF OPERATIONS — FOR THE YEAR ENDED DECEMBER 31, 2015

(continued)

| | High Income Bond Fund II† | Financial Services Fund†† | Health Care Fund††† | Russell 2000 1.5x Strategy Fund | Nova Fund†††† |
|--|---------------------------------|---------------------------------|---------------------------|---------------------------------------|------------------|
| Net Investment Income (Loss): | | | | | |
| Dividends | \$ — | \$ — | \$ — | \$ — | \$ — |
| Expense: | | | | | |
| Mortality and expense risk and administration charges | — | — | — | 306 | 751 |
| Net investment income (loss) | <u>—</u> | <u>—</u> | <u>—</u> | <u>(306)</u> | <u>(751)</u> |
| Net Realized and Unrealized Gains (Losses) on Investments: | | | | | |
| Realized gain (loss) from redemption of fund shares | — | — | — | 273 | 6,501 |
| Realized gains distributions | — | — | — | — | — |
| Net realized gain (loss) from investment transactions | — | — | — | 273 | 6,501 |
| Net change in unrealized gain (loss) of investments | — | — | — | (2,172) | (902) |
| Net realized and unrealized gain (loss) on investments | <u>—</u> | <u>—</u> | <u>—</u> | <u>(1,899)</u> | <u>5,599</u> |
| Net increase (decrease) in net assets resulting from operations | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$(2,205)</u> | <u>\$4,848</u> |

† High Income Bond III Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

†† Financial Services Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

††† Health Care Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

†††† Nova Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF OPERATIONS — FOR THE YEAR ENDED DECEMBER 31, 2015

(continued)

| | NASDAQ-100 Fund#### | Technology Fund#### | Inverse S&P 500 Strategy Fund##### | Government Long Bond 1.2x Strategy Fund | U.S. Government Money Market Fund |
|--|------------------------|------------------------|--|---|---|
| Net Investment Income (Loss): | | | | | |
| Dividends | \$ — | \$ — | \$ — | \$ 495 | \$ — |
| Expense: | | | | | |
| Mortality and expense risk and administration charges | 1,111 | 177 | — | 570 | 63 |
| Net investment income (loss) | <u>(1,111)</u> | <u>(177)</u> | <u>—</u> | <u>(75)</u> | <u>(63)</u> |
| Net Realized and Unrealized Gains (Losses) on Investments: | | | | | |
| Realized gain (loss) from redemption of fund shares | 2,167 | (858) | — | (37) | — |
| Realized gains distributions | 9,411 | 171 | — | — | — |
| Net realized gain (loss) from investment transactions | 11,578 | (687) | — | (37) | — |
| Net change in unrealized gain (loss) of investments | 428 | — | — | (3,927) | — |
| Net realized and unrealized gain (loss) on investments | <u>12,006</u> | <u>(687)</u> | <u>—</u> | <u>(3,964)</u> | <u>—</u> |
| Net increase (decrease) in net assets resulting from operations | <u>\$10,895</u> | <u>\$(864)</u> | <u>\$ —</u> | <u>\$(4,039)</u> | <u>\$(63)</u> |

NASDAQ-100 Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

Technology Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

Inverse S&P 500 Strategy Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF OPERATIONS — FOR THE YEAR ENDED DECEMBER 31, 2015

(continued)

| | Utilities Fund##### | Equity Income Portfolio II | International Stock Portfolio |
|--|------------------------|----------------------------------|-------------------------------------|
| Net Investment Income (Loss): | | | |
| Dividends | \$ — | \$ 1,506 | \$ 436 |
| Expense: | | | |
| Mortality and expense risk and administration charges | — | 793 | 592 |
| Net investment income (loss) | <u>—</u> | <u>713</u> | <u>(156)</u> |
| Net Realized and Unrealized Gains (Losses) on Investments: | | | |
| Realized gain (loss) from redemption of fund shares | — | (153) | 181 |
| Realized gains distributions | — | 3,445 | 871 |
| Net realized gain (loss) from investment transactions | — | 3,292 | 1,052 |
| Net change in unrealized gain (loss) of investments | — | (11,980) | (4,914) |
| Net realized and unrealized gain (loss) on investments | <u>—</u> | <u>(8,688)</u> | <u>(3,862)</u> |
| Net increase (decrease) in net assets resulting from operations | <u>\$ —</u> | <u>\$ (7,975)</u> | <u>\$(4,018)</u> |

Utilities Fund held no assets at December 31, 2014 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF CHANGES IN NET ASSETS — FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

| | Total | | Money Market Fund | | Limited Maturity Bond Fund | |
|--|------------------------|------------------------|----------------------|----------------------|----------------------------|------------------------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ (79,994,172) | \$ (73,963,521) | \$ (943,530) | \$ (1,141,964) | \$ (1,255,396) | \$ (1,223,590) |
| Net realized gains (losses) from investment transactions | 246,135,439 | 225,832,705 | — | — | 536,816 | 455,946 |
| Net change in unrealized gain (loss) of investments | (130,249,179) | 266,402,296 | — | — | 251,058 | (310,196) |
| Net increase (decrease) in net assets resulting from operations | 35,892,088 | 418,271,480 | (943,530) | (1,141,964) | (467,522) | (1,077,840) |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | 417,235,278 | 431,336,706 | 12,566,363 | 8,019,846 | 4,329,864 | 4,910,573 |
| Surrender benefits | (399,904,611) | (373,062,382) | (20,285,511) | (26,204,744) | (8,486,909) | (7,809,384) |
| Net transfers | 151,042,523 | 156,443,129 | 1,187,110 | 28,434,155 | 1,239,701 | 14,478,404 |
| Payments for supplementary contracts without life contingency | (5,261) | (5,180) | — | — | — | — |
| Payments for supplementary contracts with life contingency | (81,156) | (102,295) | — | — | — | — |
| Contract administration charges | (58,617,950) | (50,951,770) | (731,910) | (963,535) | (988,325) | (905,530) |
| Annuity benefits | (48,838,415) | (43,673,948) | (1,495,903) | (894,525) | (1,672,993) | (1,138,235) |
| Net increase (decrease) in net assets resulting from variable annuity activities | 60,830,408 | 119,984,260 | (8,759,851) | 8,391,197 | (5,578,662) | 9,535,828 |
| Total increase (decrease) in net assets | 96,722,496 | 538,255,740 | (9,703,381) | 7,249,233 | (6,046,184) | 8,457,988 |
| Net Assets: | | | | | | |
| Beginning of year | 5,927,019,196 | 5,388,763,456 | 84,205,368 | 76,956,135 | 99,241,901 | 90,783,913 |
| End of year | <u>\$6,023,741,692</u> | <u>\$5,927,019,196</u> | <u>\$ 74,501,987</u> | <u>\$ 84,205,368</u> | <u>\$ 93,195,717</u> | <u>\$ 99,241,901</u> |
| | Quality Bond Fund | | High Yield Bond Fund | | Flexibly Managed Fund | |
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ (3,467,580) | \$ (3,559,785) | \$ (1,680,440) | \$ (1,717,984) | \$ (37,652,224) | \$ (32,656,996) |
| Net realized gains (losses) from investment transactions | 5,125,942 | 6,938,593 | 5,831,631 | 8,299,616 | 85,965,819 | 71,544,217 |
| Net change in unrealized gain (loss) of investments | (4,049,074) | 6,738,279 | (9,791,500) | (5,994,467) | 48,495,709 | 212,607,950 |
| Net increase (decrease) in net assets resulting from operations | (2,390,712) | 10,117,087 | (5,640,309) | 587,165 | 96,809,304 | 251,495,171 |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | 16,271,130 | 12,825,145 | 5,867,039 | 8,374,201 | 243,489,357 | 232,381,536 |
| Surrender benefits | (22,731,984) | (20,413,631) | (10,663,254) | (9,601,973) | (169,065,644) | (152,930,949) |
| Net transfers | 3,689,616 | (12,131,143) | (616,031) | 4,042,063 | 128,374,206 | 78,675,222 |
| Payments for supplementary contracts without life contingency | (287) | (297) | (413) | (440) | (1,842) | (1,787) |
| Payments for supplementary contracts with life contingency | — | — | (2,129) | (2,215) | (22,353) | (27,415) |
| Contract administration charges | (2,445,794) | (2,410,297) | (1,191,617) | (1,133,432) | (27,490,545) | (22,233,504) |
| Annuity benefits | (2,386,416) | (2,928,064) | (995,201) | (1,366,359) | (23,160,582) | (19,417,882) |
| Net increase (decrease) in net assets resulting from variable annuity activities | (7,603,735) | (25,058,287) | (7,601,606) | 311,845 | 152,122,597 | 116,445,221 |
| Total increase (decrease) in net assets | (9,994,447) | (14,941,200) | (13,241,915) | 899,010 | 248,931,901 | 367,940,392 |
| Net Assets: | | | | | | |
| Beginning of year | 267,380,170 | 282,321,370 | 130,586,100 | 129,687,090 | 2,675,763,880 | 2,307,823,488 |
| End of year | <u>\$ 257,385,723</u> | <u>\$ 267,380,170</u> | <u>\$117,344,185</u> | <u>\$130,586,100</u> | <u>\$2,924,695,781</u> | <u>\$2,675,763,880</u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF CHANGES IN NET ASSETS — FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

(continued)

| | Balanced Fund | | Large Growth Stock Fund | | Large Cap Growth Fund | |
|--|------------------------|---------------------|-------------------------|----------------------|-----------------------|---------------------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ (737,604) | \$ (721,492) | \$ (2,490,282) | \$ (2,179,299) | \$ (343,293) | \$ (317,028) |
| Net realized gains (losses) from investment transactions | 3,359,324 | 3,282,007 | 14,649,596 | 11,739,490 | 1,170,171 | 1,678,197 |
| Net change in unrealized gain (loss) of investments | (2,976,456) | 1,896,190 | 3,831,379 | 1,935,100 | (1,216,812) | 950,434 |
| Net increase (decrease) in net assets resulting from operations | (354,736) | 4,456,705 | 15,990,693 | 11,495,291 | (389,934) | 2,311,603 |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | 1,944,237 | 2,946,778 | 12,385,027 | 14,270,380 | 2,184,489 | 2,160,387 |
| Surrender benefits | (4,265,866) | (4,137,305) | (10,912,038) | (8,932,118) | (1,758,865) | (1,771,839) |
| Net transfers | 67,558 | 1,322,108 | 339,244 | 3,363,527 | 756,977 | (1,300,294) |
| Payments for supplementary contracts without life contingency | — | — | (1,060) | (993) | — | — |
| Payments for supplementary contracts with life contingency | — | — | — | — | — | — |
| Contract administration charges | (470,364) | (492,751) | (1,592,768) | (1,311,567) | (227,742) | (200,701) |
| Annuity benefits | (546,695) | (820,649) | (1,095,264) | (1,190,141) | (73,219) | (171,727) |
| Net increase (decrease) in net assets resulting from variable annuity activities | (3,271,130) | (1,181,819) | (876,859) | 6,199,088 | 881,640 | (1,284,174) |
| Total increase (decrease) in net assets | (3,625,866) | 3,274,886 | 15,113,834 | 17,694,379 | 491,706 | 1,027,429 |
| Net Assets: | | | | | | |
| Beginning of year | 57,974,055 | 54,699,169 | 179,666,252 | 161,971,873 | 25,559,973 | 24,532,544 |
| End of year | <u>\$54,348,189</u> | <u>\$57,974,055</u> | <u>\$194,780,086</u> | <u>\$179,666,252</u> | <u>\$26,051,679</u> | <u>\$25,559,973</u> |
| | | | | | | |
| | Large Core Growth Fund | | Large Cap Value Fund | | Large Core Value Fund | |
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ (796,244) | \$ (794,738) | \$ (1,519,974) | \$ (1,495,644) | \$ (1,173,825) | \$ (1,156,338) |
| Net realized gains (losses) from investment transactions | 4,763,795 | 4,287,172 | 7,232,365 | 6,279,910 | 7,346,856 | 5,377,568 |
| Net change in unrealized gain (loss) of investments | (3,737,860) | 383,576 | (12,285,121) | 6,261,725 | (8,162,253) | 4,144,946 |
| Net increase (decrease) in net assets resulting from operations | 229,691 | 3,876,010 | (6,572,730) | 11,045,991 | (1,989,222) | 8,366,176 |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | 2,155,201 | 2,927,840 | 3,031,613 | 4,036,727 | 3,901,780 | 3,204,546 |
| Surrender benefits | (4,220,473) | (4,652,959) | (8,714,539) | (9,256,869) | (7,196,771) | (6,207,377) |
| Net transfers | (3,004,549) | (1,226,468) | 2,568,915 | 5,056,268 | (1,548,004) | 140,127 |
| Payments for supplementary contracts without life contingency | — | — | (1,027) | (1,042) | — | — |
| Payments for supplementary contracts with life contingency | — | — | (13,892) | (18,431) | (16,324) | (21,698) |
| Contract administration charges | (332,649) | (303,508) | (759,872) | (664,912) | (698,956) | (644,050) |
| Annuity benefits | (785,433) | (327,164) | (1,278,045) | (1,030,889) | (678,425) | (785,870) |
| Net increase (decrease) in net assets resulting from variable annuity activities | (6,187,903) | (3,582,259) | (5,166,847) | (1,879,148) | (6,236,700) | (4,314,322) |
| Total increase (decrease) in net assets | (5,958,212) | 293,751 | (11,739,577) | 9,166,843 | (8,225,922) | 4,051,854 |
| Net Assets: | | | | | | |
| Beginning of year | 63,644,134 | 63,350,383 | 122,055,628 | 112,888,785 | 93,653,609 | 89,601,755 |
| End of year | <u>\$57,685,922</u> | <u>\$63,644,134</u> | <u>\$110,316,051</u> | <u>\$122,055,628</u> | <u>\$85,427,687</u> | <u>\$93,653,609</u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF CHANGES IN NET ASSETS — FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

(continued)

| | Index 500 Fund | | Mid Cap Growth Fund | | Mid Cap Value Fund | |
|--|----------------------|----------------------|----------------------|---------------------|----------------------|----------------------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ (3,250,891) | \$ (2,917,681) | \$ (975,360) | \$ (1,001,875) | \$ (1,511,177) | \$ (1,442,360) |
| Net realized gains (losses) from investment transactions | 18,042,704 | 12,753,636 | 4,761,062 | 5,975,681 | 10,470,232 | 8,785,337 |
| Net change in unrealized gain (loss) of investments | (15,672,125) | 15,635,717 | (8,945,645) | 1,074,912 | (19,585,287) | 5,660,191 |
| Net increase (decrease) in net assets resulting from operations | (880,312) | 25,471,672 | (5,159,943) | 6,048,718 | (10,626,232) | 13,003,168 |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | 13,471,873 | 15,832,169 | 3,225,445 | 3,142,171 | 9,126,328 | 8,403,787 |
| Surrender benefits | (15,312,101) | (12,433,741) | (5,312,993) | (4,936,960) | (9,355,879) | (7,164,452) |
| Net transfers | 6,540,169 | 12,332,348 | 387,013 | (2,389,342) | 553,688 | (2,266,670) |
| Payments for supplementary contracts without life contingency | (632) | (621) | — | — | — | — |
| Payments for supplementary contracts with life contingency | — | — | — | — | — | — |
| Contract administration charges | (2,471,347) | (2,033,989) | (652,661) | (628,477) | (956,621) | (846,861) |
| Annuity benefits | (1,163,224) | (1,849,874) | (528,978) | (664,187) | (665,882) | (905,920) |
| Net increase (decrease) in net assets resulting from variable annuity activities | 1,064,738 | 11,846,292 | (2,882,174) | (5,476,795) | (1,298,366) | (2,780,116) |
| Total increase (decrease) in net assets | 184,426 | 37,317,964 | (8,042,117) | 571,923 | (11,924,598) | 10,223,052 |
| Net Assets: | | | | | | |
| Beginning of year | 245,906,551 | 208,588,587 | 78,166,078 | 77,594,155 | 116,883,765 | 106,660,713 |
| End of year | <u>\$246,090,977</u> | <u>\$245,906,551</u> | <u>\$70,123,961</u> | <u>\$78,166,078</u> | <u>\$104,959,167</u> | <u>\$116,883,765</u> |
| | Mid Core Value Fund | | SMID Cap Growth Fund | | SMID Cap Value Fund | |
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ (600,747) | \$ (568,907) | \$ (540,978) | \$ (452,776) | \$ (582,113) | \$ (494,400) |
| Net realized gains (losses) from investment transactions | 6,520,664 | 2,943,722 | 2,649,277 | 2,589,742 | 2,147,142 | 2,859,444 |
| Net change in unrealized gain (loss) of investments | (7,245,051) | 3,786,761 | (3,559,908) | (2,431,204) | (4,642,725) | 451,001 |
| Net increase (decrease) in net assets resulting from operations | (1,325,134) | 6,161,576 | (1,451,609) | (294,238) | (3,077,696) | 2,816,045 |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | 3,455,971 | 4,251,499 | 3,522,828 | 3,906,143 | 3,688,445 | 4,494,642 |
| Surrender benefits | (4,210,199) | (3,269,131) | (1,843,540) | (1,164,393) | (1,478,180) | (1,576,365) |
| Net transfers | (5,588,753) | 1,723,415 | 3,729,926 | 3,211,524 | 354,557 | 4,448,878 |
| Payments for supplementary contracts without life contingency | — | — | — | — | — | — |
| Payments for supplementary contracts with life contingency | — | — | — | — | — | — |
| Contract administration charges | (464,880) | (392,744) | (437,951) | (346,570) | (489,103) | (378,526) |
| Annuity benefits | (251,306) | (395,886) | (148,527) | (103,541) | (63,108) | (215,945) |
| Net increase (decrease) in net assets resulting from variable annuity activities | (7,059,167) | 1,917,153 | 4,822,736 | 5,503,163 | 2,012,611 | 6,772,684 |
| Total increase (decrease) in net assets | (8,384,301) | 8,078,729 | 3,371,127 | 5,208,925 | (1,065,085) | 9,588,729 |
| Net Assets: | | | | | | |
| Beginning of year | 49,675,998 | 41,597,269 | 36,346,943 | 31,138,018 | 42,139,410 | 32,550,681 |
| End of year | <u>\$ 41,291,697</u> | <u>\$ 49,675,998</u> | <u>\$39,718,070</u> | <u>\$36,346,943</u> | <u>\$ 41,074,325</u> | <u>\$ 42,139,410</u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF CHANGES IN NET ASSETS — FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

(continued)

| | Small Cap Growth Fund | | Small Cap Value Fund | | Small Cap Index Fund | |
|--|-----------------------|---------------------|----------------------|----------------------|----------------------|----------------------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ (691,027) | \$ (643,111) | \$ (2,075,698) | \$ (2,022,956) | \$ (651,521) | \$ (592,202) |
| Net realized gains (losses) from investment transactions | 3,514,771 | 3,420,771 | 10,312,265 | 11,854,151 | 2,122,742 | 3,188,497 |
| Net change in unrealized gain (loss) of investments | (3,263,014) | 446,453 | (19,043,664) | (765,732) | (4,645,547) | (1,132,393) |
| Net increase (decrease) in net assets resulting from operations | (439,270) | 3,224,113 | (10,807,097) | 9,065,463 | (3,174,326) | 1,463,902 |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | 2,755,914 | 2,452,101 | 8,418,797 | 11,077,666 | 2,998,554 | 3,626,090 |
| Surrender benefits | (4,713,363) | (2,541,777) | (10,264,940) | (9,380,868) | (1,775,001) | (1,267,440) |
| Net transfers | 875,904 | (281,866) | 1,354,493 | (1,170,234) | 2,510,570 | 1,966,020 |
| Payments for supplementary contracts without life contingency | — | — | — | — | — | — |
| Payments for supplementary contracts with life contingency | — | — | (22,694) | (29,115) | — | — |
| Contract administration charges | (411,272) | (291,632) | (1,327,295) | (1,161,928) | (575,634) | (491,519) |
| Annuity benefits | (328,337) | (434,510) | (1,088,354) | (1,091,116) | (76,511) | (231,654) |
| Net increase (decrease) in net assets resulting from variable annuity activities | (1,821,154) | (1,097,684) | (2,929,993) | (1,755,595) | 3,081,978 | 3,601,497 |
| Total increase (decrease) in net assets | (2,260,424) | 2,126,429 | (13,737,090) | 7,309,868 | (92,348) | 5,065,399 |
| Net Assets: | | | | | | |
| Beginning of year | 53,215,549 | 51,089,120 | 163,561,074 | 156,251,206 | 47,586,006 | 42,520,607 |
| End of year | <u>\$50,955,125</u> | <u>\$53,215,549</u> | <u>\$149,823,984</u> | <u>\$163,561,074</u> | <u>\$ 47,493,658</u> | <u>\$ 47,586,006</u> |
| Developed International Index Fund | | | | | | |
| International Equity Fund | | | | | | |
| Emerging Markets Equity Fund | | | | | | |
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ (684,425) | \$ (663,184) | \$ (2,900,316) | \$ (2,899,213) | \$ (1,344,035) | \$ (1,440,983) |
| Net realized gains (losses) from investment transactions | 1,703,664 | 2,428,393 | 6,448,969 | 4,551,248 | 1,048,755 | 2,435,224 |
| Net change in unrealized gain (loss) of investments | (2,534,781) | (5,505,479) | 1,283,558 | 2,112,140 | (12,057,779) | (7,781,549) |
| Net increase (decrease) in net assets resulting from operations | (1,515,542) | (3,740,270) | 4,832,211 | 3,764,175 | (12,353,059) | (6,787,308) |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | 3,028,667 | 3,405,630 | 8,197,858 | 9,549,883 | 4,998,023 | 7,113,808 |
| Surrender benefits | (2,090,980) | (1,836,834) | (13,474,879) | (13,532,619) | (5,539,782) | (5,812,579) |
| Net transfers | 1,906,087 | 4,770,882 | 621,262 | 4,976,181 | 1,973,674 | 1,415,322 |
| Payments for supplementary contracts without life contingency | — | — | — | — | — | — |
| Payments for supplementary contracts with life contingency | — | — | — | — | — | — |
| Contract administration charges | (624,287) | (580,032) | (1,903,604) | (1,789,601) | (1,092,407) | (1,084,314) |
| Annuity benefits | (270,342) | (100,340) | (1,501,339) | (1,357,970) | (526,937) | (479,903) |
| Net increase (decrease) in net assets resulting from variable annuity activities | 1,949,145 | 5,659,306 | (8,060,702) | (2,154,126) | (187,429) | 1,152,334 |
| Total increase (decrease) in net assets | 433,603 | 1,919,036 | (3,228,491) | 1,610,049 | (12,540,488) | (5,634,974) |
| Net Assets: | | | | | | |
| Beginning of year | 49,365,626 | 47,446,590 | 220,667,570 | 219,057,521 | 104,566,513 | 110,201,487 |
| End of year | <u>\$49,799,229</u> | <u>\$49,365,626</u> | <u>\$217,439,079</u> | <u>\$220,667,570</u> | <u>\$ 92,026,025</u> | <u>\$104,566,513</u> |

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF CHANGES IN NET ASSETS — FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

(continued)

| | Real Estate Securities Fund | | Aggressive Allocation Fund | | Moderately Aggressive Allocation Fund | | Moderate Allocation Fund | |
|--|-----------------------------|----------------------|----------------------------|---------------------|---------------------------------------|----------------------|--------------------------|----------------------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | | | |
| Net investment income (loss) | \$ (1,325,920) | \$ (1,171,341) | \$ (832,265) | \$ (771,711) | \$ (3,196,663) | \$ (3,071,962) | \$ (4,626,346) | \$ (4,616,042) |
| Net realized gains (losses) from investment transactions | 8,982,798 | 11,042,956 | 3,138,802 | 2,698,411 | 8,954,148 | 9,374,266 | 13,429,479 | 12,194,971 |
| Net change in unrealized gain (loss) of investments | (3,904,964) | 12,443,897 | (4,124,919) | 1,113,434 | (11,600,146) | 4,877,037 | (15,112,345) | 6,908,168 |
| Net increase (decrease) in net assets resulting from operations | 3,751,914 | 22,315,512 | (1,818,382) | 3,040,134 | (5,842,661) | 11,179,341 | (6,309,212) | 14,487,097 |
| Variable Annuity Activities: | | | | | | | | |
| Purchase payments | 6,888,671 | 6,795,331 | 4,497,601 | 7,671,586 | 11,303,153 | 14,795,889 | 12,466,439 | 21,298,425 |
| Surrender benefits | (5,930,066) | (4,950,229) | (2,753,112) | (2,783,303) | (12,999,199) | (13,527,569) | (20,106,050) | (20,847,143) |
| Net transfers | (139,294) | (5,062,036) | (1,623,170) | 577,015 | 543,870 | 9,695,716 | 523,127 | 3,586,891 |
| Payments for supplementary contracts without life contingency | — | — | — | — | — | — | — | — |
| Payments for supplementary contracts with life contingency | (3,764) | (3,421) | — | — | — | — | — | — |
| Contract administration charges | (970,653) | (806,842) | (763,707) | (661,649) | (2,820,038) | (2,547,701) | (4,048,926) | (3,915,379) |
| Annuity benefits | (573,582) | (758,171) | (46,802) | (603,984) | (675,643) | (880,425) | (5,065,512) | (1,625,579) |
| Net increase (decrease) in net assets resulting from variable annuity activities | (728,688) | (4,785,368) | (689,190) | 4,199,665 | (4,647,857) | 7,535,910 | (16,230,922) | (1,502,785) |
| Total increase (decrease) in net assets | 3,023,226 | 17,530,144 | (2,507,572) | 7,239,799 | (10,490,518) | 18,715,251 | (22,540,134) | 12,984,312 |
| Net Assets: | | | | | | | | |
| Beginning of year | 98,707,472 | 81,177,328 | 61,333,257 | 54,093,458 | 239,600,535 | 220,885,284 | 353,318,651 | 340,334,339 |
| End of year | <u>\$101,730,698</u> | <u>\$ 98,707,472</u> | <u>\$58,825,685</u> | <u>\$61,333,257</u> | <u>\$229,110,017</u> | <u>\$239,600,535</u> | <u>\$330,778,517</u> | <u>\$353,318,651</u> |

| | Moderately Conservative Allocation Fund | | Conservative Allocation Fund | | High Income Bond Fund II† | | Financial Services Fund‡ | |
|--|---|----------------------|------------------------------|---------------------|---------------------------|-------------|--------------------------|-------------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | | | |
| Net investment income (loss) | \$ (1,366,488) | \$ (1,394,020) | \$ (775,884) | \$ (829,932) | — | \$ (1) | — | — |
| Net realized gains (losses) from investment transactions | 4,254,299 | 4,791,593 | 1,629,379 | 2,007,588 | — | 52 | — | — |
| Net change in unrealized gain (loss) of investments | (4,395,187) | 531,161 | (1,535,253) | 389,746 | — | (44) | — | — |
| Net increase (decrease) in net assets resulting from operations | (1,507,376) | 3,928,734 | (681,758) | 1,567,402 | — | 7 | — | — |
| Variable Annuity Activities: | | | | | | | | |
| Purchase payments | 5,380,433 | 6,469,206 | 1,684,178 | 992,721 | — | — | — | — |
| Surrender benefits | (8,925,823) | (8,097,819) | (5,500,703) | (5,999,302) | — | (792) | — | — |
| Net transfers | 1,408,178 | (3,260,452) | 2,056,091 | 1,315,599 | — | — | — | — |
| Payments for supplementary contracts without life contingency | — | — | — | — | — | — | — | — |
| Payments for supplementary contracts with life contingency | — | — | — | — | — | — | — | — |
| Contract administration charges | (1,084,980) | (1,103,576) | (591,445) | (626,013) | — | — | — | — |
| Annuity benefits | (1,013,097) | (964,091) | (682,758) | (939,347) | — | — | — | — |
| Net increase (decrease) in net assets resulting from variable annuity activities | (4,235,289) | (6,956,732) | (3,034,637) | (5,256,342) | — | (792) | — | — |
| Total increase (decrease) in net assets | (5,742,665) | (3,027,998) | (3,716,395) | (3,688,940) | — | (785) | — | — |
| Net Assets: | | | | | | | | |
| Beginning of year | 104,042,468 | 107,070,466 | 61,856,797 | 65,545,737 | — | 785 | — | — |
| End of year | <u>\$ 98,299,803</u> | <u>\$104,042,468</u> | <u>\$58,140,402</u> | <u>\$61,856,797</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ —</u> |

† High Income Bond Fund II held no assets at December 31, 2014 and 2015 in Account III. However, the fund is an investment option.

‡ Financial Services Fund held no assets at December 31, 2014 and 2015 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF CHANGES IN NET ASSETS — FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

(continued)

| | Health Care Fund††† | | Russell 2000 1.5x Strategy Fund | | Nova Fund†††† | |
|--|---------------------|------|------------------------------------|------------|---------------|------------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| | Operations: | | | | | |
| Net investment income (loss) | \$ — | \$ — | \$ (306) | \$ (1,073) | \$ (751) | \$ (1,550) |
| Net realized gains (losses) from investment transactions | — | — | 273 | 4,683 | 6,501 | 22,605 |
| Net change in unrealized gain (loss) of investments | — | — | (2,172) | (4,394) | (902) | (14,440) |
| Net increase (decrease) in net assets resulting from operations | — | — | (2,205) | (784) | 4,848 | 6,615 |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | — | — | — | — | — | — |
| Surrender benefits | — | — | — | (4,102) | (3,036) | (6,324) |
| Net transfers | — | — | — | (88,734) | (163,459) | 35,980 |
| Payments for supplementary contracts without life contingency | — | — | — | — | — | — |
| Payments for supplementary contracts with life contingency | — | — | — | — | — | — |
| Contract administration charges | — | — | (69) | (161) | (90) | (186) |
| Annuity benefits | — | — | — | — | — | — |
| Net increase (decrease) in net assets resulting from variable annuity activities | — | — | (69) | (92,997) | (166,585) | 29,470 |
| Total increase (decrease) in net assets | — | — | (2,274) | (93,781) | (161,737) | 36,085 |
| Net Assets: | | | | | | |
| Beginning of year | — | — | 21,285 | 115,066 | 161,737 | 125,652 |
| End of year | \$ — | \$ — | \$ 19,011 | \$ 21,285 | \$ — | \$ 161,737 |

| | NASDAQ-100 Fund††††† | | Technology Fund†††††† | | Inverse S&P 500 Strategy Fund††††††† | |
|--|-------------------------|------------|--------------------------|------|---|------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| | Operations: | | | | | |
| Net investment income (loss) | \$ (1,111) | \$ (1,038) | \$ (177) | \$ — | \$ — | \$ — |
| Net realized gains (losses) from investment transactions | 11,578 | 17,591 | (687) | — | — | — |
| Net change in unrealized gain (loss) of investments | 428 | (5,813) | — | — | — | — |
| Net increase (decrease) in net assets resulting from operations | 10,895 | 10,740 | (864) | — | — | — |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | — | — | — | — | — | — |
| Surrender benefits | (5,122) | (4,200) | (1,019) | — | — | — |
| Net transfers | (166,047) | 61,076 | 1,904 | — | — | — |
| Payments for supplementary contracts without life contingency | — | — | — | — | — | — |
| Payments for supplementary contracts with life contingency | — | — | — | — | — | — |
| Contract administration charges | (133) | (125) | (21) | — | — | — |
| Annuity benefits | — | — | — | — | — | — |
| Net increase (decrease) in net assets resulting from variable annuity activities | (171,302) | 56,751 | 864 | — | — | — |
| Total increase (decrease) in net assets | (160,407) | 67,491 | — | — | — | — |
| Net Assets: | | | | | | |
| Beginning of year | 160,407 | 92,916 | — | — | — | — |
| End of year | \$ — | \$ 160,407 | \$ — | \$ — | \$ — | \$ — |

†† Health Care Fund held no assets at December 31, 2014 and 2015 in Account III. However, the fund is an investment option.

††† Nova Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

†††† NASDAQ-100 Fund held no assets at December 31, 2015 in Account III. However, the fund is an investment option.

††††† Technology Fund held no assets at December 31, 2014 and 2015 in Account III. However, the fund is an investment option.

†††††† Inverse S&P 500 Strategy Fund held no assets at December 31, 2014 and 2015 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

STATEMENTS OF CHANGES IN NET ASSETS — FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

(continued)

| | Government Long Bond 1.2x Strategy Fund | | U.S. Government Money Market Fund | | Utilities Fund+++++ | |
|--|---|-------------|---|--|------------------------|-------------|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ (75) | \$ (110) | \$ (63) | \$ (231) | \$ — | \$ — |
| Net realized gains (losses) from investment transactions | (37) | 8,693 | — | — | — | — |
| Net change in unrealized gain (loss) of investments | (3,927) | — | — | — | — | — |
| Net increase (decrease) in net assets resulting from operations | (4,039) | 8,583 | (63) | (231) | — | — |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | — | — | — | — | — | — |
| Surrender benefits | (1,442) | — | — | (2,255) | — | — |
| Net transfers | 113,916 | (8,535) | — | 180 | — | — |
| Payments for supplementary contracts without life contingency | — | — | — | — | — | — |
| Payments for supplementary contracts with life contingency | — | — | — | — | — | — |
| Contract administration charges | (68) | (48) | (50) | (110) | — | — |
| Annuity benefits | — | — | — | — | — | — |
| Net increase (decrease) in net assets resulting from variable annuity activities | 112,406 | (8,583) | (50) | (2,185) | — | — |
| Total increase (decrease) in net assets | 108,367 | — | (113) | (2,416) | — | — |
| Net Assets: | | | | | | |
| Beginning of year | — | — | 4,434 | 6,850 | — | — |
| End of year | \$108,367 | \$ — | \$ 4,321 | \$ 4,434 | \$ — | \$ — |
| | | | Equity Income Portfolio II | International Stock Portfolio | | |
| | | | 2015 | 2014 | 2015 | 2014 |
| Operations: | | | | | | |
| Net investment income (loss) | \$ 713 | \$ (3) | \$ (156) | \$ (1) | | |
| Net realized gains (losses) from investment transactions | 3,292 | 600 | 1,052 | 134 | | |
| Net change in unrealized gain (loss) of investments | (11,980) | (654) | (4,914) | (157) | | |
| Net increase (decrease) in net assets resulting from operations | (7,975) | (57) | (4,018) | (24) | | |
| Variable Annuity Activities: | | | | | | |
| Purchase payments | — | — | — | — | | |
| Surrender benefits | (1,983) | (2,234) | (3,365) | (803) | | |
| Net transfers | 162,731 | 1 | 51,343 | 1 | | |
| Payments for supplementary contracts without life contingency | — | — | — | — | | |
| Payments for supplementary contracts with life contingency | — | — | — | — | | |
| Contract administration charges | (95) | — | (71) | — | | |
| Annuity benefits | — | — | — | — | | |
| Net increase (decrease) in net assets resulting from variable annuity activities | 160,653 | (2,233) | 47,907 | (802) | | |
| Total increase (decrease) in net assets | 152,678 | (2,290) | 43,889 | (826) | | |
| Net Assets: | | | | | | |
| Beginning of year | — | 2,290 | — | 826 | | |
| End of year | \$152,678 | \$ — | \$43,889 | \$ — | | |

+++++ Utilities Fund held no assets at December 31, 2014 and 2015 in Account III. However, the fund is an investment option.

The accompanying notes are an integral part of these financial statements.

PENN MUTUAL VARIABLE ANNUITY ACCOUNT III

Notes to Financial Statements — December 31, 2015

Note 1. Organization

Penn Mutual Variable Annuity Account III (“Account III”) was established by The Penn Mutual Life Insurance Company (“Penn Mutual”) under the provisions of the Pennsylvania Insurance Law. Account III is registered under the Investment Company Act of 1940, as amended, as a unit investment trust. Account III offers units to variable annuity contract owners to provide for the accumulation of value and for the payment of annuities. Account III contains contracts of the Diversifier II, Optimizer, Commander, Penn Freedom, Enhanced Credit Variable Annuity, Pennant Select, Olympia XT Advisor, Penn Freedom Advisor, Retirement Planner VA, Inflation Protector, Smart Foundation Flex, Smart Foundation Plus and Smart Foundation VA variable annuity products. Under applicable insurance law, the assets and liabilities of Account III are legally segregated from Penn Mutual’s other assets and liabilities.

Note 2. Significant Accounting Policies

The preparation of the accompanying financial statements and notes are in accordance with accounting principles generally accepted in the United States of America, which requires management to make estimates and assumptions that affect the reported values of assets and liabilities and the reported amounts from operations and contract transactions during the reporting period. Actual results could differ significantly with those estimates.

The significant accounting policies of Account III are as follows:

Investments — Assets of Account III are invested into subaccounts which are invested in shares of Penn Series Funds, Inc. (“Penn Series”), an affiliated entity of Penn Mutual: Money Market, Limited Maturity Bond, Quality Bond, High Yield Bond, Flexibly Managed, Balanced, Large Growth Stock, Large Cap Growth, Large Core Growth, Large Cap Value, Large Core Value, Index 500, Mid Cap Growth, Mid Cap Value, Mid Core Value, SMID Cap Growth, SMID Cap Value, Small Cap Growth, Small Cap Value, Small Cap Index, Developed International Index, International Equity, Emerging Markets Equity, Real Estate Securities, Aggressive Allocation, Moderately Aggressive Allocation, Moderate Allocation, Moderately Conservative Allocation and Conservative Allocation Funds; Federated Insurance Series (“Federated”): High Income Bond Fund II; Rydex Variable Trust (“Rydex”): Financial Services, Health Care, Russell 2000 1.5x Strategy, Nova, NASDAQ-100, Technology, Inverse S&P 500 Strategy, Government Long Bond 1.2x Strategy, U.S. Government Money Market, and Utilities Funds; T. Rowe Price Equity Series, Inc. (“T. Rowe”): Equity Income Portfolio II, and T. Rowe Price International Series, Inc. (“T. Rowe”): International Stock Portfolio.

Penn Series, Federated, Rydex, and T. Rowe are open-end diversified management investment companies.

REVISIONS The Financial Highlights within Note 6 for the years ended December 31, 2013, 2012, and 2011 have been adjusted to incorporate the correct expense ratios at the lowest and highest level of the range. The expense ratios for the V.I. Capital Appreciation, Federated, Rydex and T. Rowe Funds had incorrectly reflected the lowest and highest level of the range for all products within Account III for those respective years. The correction resulted in an increase in the lowest level expense ratio disclosed for each fund by 0.15% for the years ended December 31, 2013, 2012, and 2011 and a decrease in the highest level expense ratio disclosed for each fund by 0.05% for the years ended December 31, 2013, 2012 and 2011.

The investment in shares of these funds or portfolios is carried at fair market value as determined by the underlying net asset value of the respective funds or portfolios. Investment transactions are accounted for on a trade date basis. The resulting net unrealized gains (losses) are reflected in the Statements of Operations. Realized gains (losses) from securities transactions are determined for federal income tax and for financial reporting purposes on the FIFO cost basis.

The amounts shown as receivable for securities sold and payable for securities purchased on the Statements of Assets and Liabilities reflect transactions that occurred on the last business day of the reporting period. These amounts will be deposited to or withdrawn from the separate account in accordance with the contract owners’ instructions on the first business day subsequent to the close of the period presented.

All dividend distributions received from the underlying Penn Series Funds are reinvested in additional shares of these Funds and are recorded by Account III on the ex-dividend date. The Penn Series Funds have utilized consent dividends to effectively distribute income for income tax purposes. Account III consents to treat these amounts as dividend income for

Note 2. Significant Accounting Policies (continued)

tax purposes although they are not paid by the underlying Penn Series Funds. Therefore, no dividend income is recorded in the statements of operations related to such consent dividends.

For the year ended December 31, 2015, consent dividends in Account III were:

| | <u>Consent Dividends</u> |
|---|--------------------------|
| Limited Maturity Bond Fund | \$ 1,430,524 |
| Quality Bond Fund | 11,825,402 |
| High Yield Bond Fund | 8,029,196 |
| Flexibly Managed Fund | 293,895,965 |
| Balanced Fund | 4,288,887 |
| Large Growth Stock Fund | 21,323,847 |
| Large Cap Growth Fund | 3,122,233 |
| Large Core Growth Fund | 5,384,592 |
| Large Cap Value Fund | 6,804,113 |
| Large Core Value Fund | 9,064,828 |
| Index 500 Fund | 8,681,832 |
| Mid Cap Growth Fund | 3,763,528 |
| Mid Cap Value Fund | 19,300,777 |
| Mid Core Value Fund | 4,041,178 |
| SMID Cap Growth Fund | 3,377,521 |
| SMID Cap Value Fund | 3,198,235 |
| Small Cap Growth Fund | 4,504,847 |
| Small Cap Value Fund | 10,123,871 |
| Small Cap Index Fund | 2,939,730 |
| Developed International Index Fund | 1,077,625 |
| International Equity Fund | 2,980,835 |
| Emerging Markets Equity Fund | 266,342 |
| Real Estate Securities Fund | 11,358,993 |
| Aggressive Allocation Fund | 8,360,306 |
| Moderately Aggressive Allocation Fund | 30,425,606 |
| Moderate Allocation Fund | 38,143,274 |
| Moderately Conservative Allocation Fund | 10,106,753 |
| Conservative Allocation Fund | 5,513,414 |

Consent dividends were utilized by the Penn Series Funds only.

Federal Income Taxes — The operations of Account III are included in the federal income tax return of Penn Mutual, which is taxed as a life insurance company under the provisions of the Internal Revenue Code (“IRC”). Under the current provisions of the IRC, Penn Mutual does not expect to incur federal income taxes on the earnings of Account III to the extent the earnings are credited under the contracts. Based on this, there is no charge to Account III for federal income taxes. Penn Mutual will review, as needed, the status of this policy in the event of changes in the tax law. A charge may be made in future years for any federal income taxes that would be attributable to the contracts.

Under the provisions of Section 817(h) of the IRC, a variable annuity contract will not be treated as an annuity contract for federal tax purposes for any period for which the investments of the segregated asset account on which the contract is based are not adequately diversified. The IRC provides that the “adequately diversified” requirement may be met if the underlying investments satisfy either a statutory safe harbor test or diversification requirements set forth in regulations issued by the Secretary of Treasury. Account III satisfies the current requirements of the regulations, and Penn Mutual intends that Account III will continue to meet such requirements.

Fair Value Measurement — Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurement is based on assumptions market participants would make in pricing an asset or liability. The inputs to valuation techniques used to measure fair value are prioritized by establishing a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to prices derived from unobservable inputs. An asset or

Note 2. Significant Accounting Policies (continued)

liability's classification within the fair value hierarchy is based on the lowest level of significant input to its fair value measurement. Account III has categorized its assets and liabilities into the three-level fair value hierarchy based upon the priority of the inputs. The following summarizes the types of assets and liabilities included within the three-level hierarchy:

Level 1 — Fair value is based on unadjusted quoted market prices in active markets for identical assets or liabilities that are accessible at the measurement date. These generally provide the most reliable evidence and are used to measure fair value whenever available. Active markets are defined as having the following for the measured asset/liability: i) many transactions, ii) current prices, iii) price quotes not varying substantially among market makers. iv) narrow bid/ask spreads and v) most information publicly available. Prices are obtained from readily available sources for market transactions involving identical assets or liabilities.

Level 2 — Fair value is based on significant inputs, other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability through corroboration with observable market data. In circumstances where prices from pricing services are reviewed for reasonability but cannot be validated to observable market data as noted above, these security values are recorded in Level 3 in our fair value hierarchy.

Level 3 — Fair value is based on significant inputs that are unobservable for the asset or liability. These inputs reflect the Penn Mutual's assumptions about the assumptions market participants would use in pricing the asset or liability. These are typically less liquid fixed maturity securities with very limited trading activity. Prices are determined using valuation methodologies such as option pricing models, discounted cash flow models and other similar techniques. Prices may also be based upon non-binding quotes from brokers or other market makers that are reviewed for reasonableness, based on Penn Mutual's understanding of the market.

The fair value of all the investments in Account III, are at net asset values and the investments are considered actively traded and fall within Level 1.

Note 3. Purchases and Sales of Investments

The following table shows aggregate cost of shares purchased and proceeds of shares redeemed of each fund or portfolio for the period ended December 31, 2015:

| | <u>Purchases</u> | <u>Sales</u> |
|---------------------------------------|------------------|--------------|
| Money Market Fund | \$ 49,383,929 | \$59,094,563 |
| Limited Maturity Bond Fund | 28,591,200 | 35,425,257 |
| Quality Bond Fund | 17,815,004 | 28,886,319 |
| High Yield Bond Fund | 9,153,756 | 18,435,802 |
| Flexibly Managed Fund | 190,505,221 | 76,034,852 |
| Balanced Fund | 2,916,294 | 6,925,028 |
| Large Growth Stock Fund | 14,528,570 | 17,895,711 |
| Large Cap Growth Fund | 3,108,993 | 2,570,646 |
| Large Core Growth Fund | 1,855,948 | 8,840,095 |
| Large Cap Value Fund | 6,116,900 | 12,803,721 |
| Large Core Value Fund | 5,824,422 | 13,234,948 |
| Index 500 Fund | 18,444,140 | 20,630,293 |
| Mid Cap Growth Fund | 4,492,097 | 8,349,630 |
| Mid Cap Value Fund | 8,712,863 | 11,522,406 |
| Mid Core Value Fund | 2,998,662 | 10,658,576 |
| SMID Cap Growth Fund | 10,251,333 | 5,969,576 |
| SMID Cap Value Fund | 5,524,120 | 4,093,622 |
| Small Cap Growth Fund | 5,174,677 | 7,686,858 |
| Small Cap Value Fund | 9,321,096 | 14,326,787 |
| Small Cap Index Fund | 6,010,983 | 3,580,526 |
| Developed International Index Fund | 7,086,641 | 5,821,920 |
| International Equity Fund | 9,088,066 | 20,049,085 |
| Emerging Markets Equity Fund | 8,376,003 | 9,907,466 |
| Real Estate Securities Fund | 11,080,510 | 13,135,118 |
| Aggressive Allocation Fund | 6,348,246 | 7,869,701 |
| Moderately Aggressive Allocation Fund | 12,599,230 | 20,443,749 |

Note 3. Purchases and Sales of Investments (continued)

| | <u>Purchases</u> | <u>Sales</u> |
|---|------------------|--------------|
| Moderate Allocation Fund | \$10,500,976 | \$31,358,243 |
| Moderately Conservative Allocation Fund | 11,360,009 | 16,961,786 |
| Conservative Allocation Fund | 7,663,675 | 11,474,195 |
| High Income Bond Fund II | — | — |
| Financial Services Fund | — | — |
| Health Care Fund | — | — |
| Russell 2000 1.5x Strategy Fund | — | 374 |
| Nova Fund | — | 167,336 |
| NASDAQ-100 Fund | — | 172,413 |
| Technology Fund | 33,436 | 32,748 |
| Inverse S&P 500 Strategy Fund | — | — |
| Government Long Bond 1.2x Strategy Fund | 114,166 | 2,329 |
| U.S. Government Money Market Fund | — | 113 |
| Utilities Fund | — | — |
| Equity Income Portfolio II | 163,094 | 3,233 |
| International Stock Portfolio | 67,253 | 19,938 |

Note 4. Related Party Transactions and Contract Charges

Penn Mutual received \$138,621,812 and \$124,924,481 from Account III for mortality and risk expense, contract administration and certain other charges for the years ended December 31, 2015 and 2014. These amounts charged include those assessed through a reduction in unit values as well as those assessed through the redemption of units. Additionally, Penn Series pays Penn Mutual and its affiliates fees for investment advisory and administrative services.

Certain product charges are reflected as a reduction in the value of the units held by the contract owner. These are stated as a percentage of the account value as follows:

| <u>Products</u> | <u>Mortality & Risk Expense</u> | <u>Contract Administration</u> | <u>Maximum Supplemental Rider Charge</u> |
|--------------------------------------|---|------------------------------------|--|
| Diversifier II/Optimizer | 1.25% | None | N/A |
| Commander | 1.25% | 0.15% | 0.95% |
| Penn Freedom | 1.30% | 0.15% | 0.95% |
| Enhanced Credit Variable Annuity | 1.25% | 0.15% | 0.60% |
| Pennant Select | 1.20% | 0.15% | 0.95% |
| Olympia XT Advisor | 1.25% | 0.15% | 0.60% |
| Penn Freedom Advisor | 1.45% | 0.15% | 0.60% |
| Retirement Planner VA | 1.25% | None | 0.60% |
| Inflation Protector Variable Annuity | 1.50% | 0.15% | 2.50% |
| Smart Foundation Flex | 1.50% | 0.15% | 2.75% |
| Smart Foundation Plus | 1.45% | 0.15% | 2.75% |
| Smart Foundation VA | 1.25% | 0.15% | 2.75% |

Certain product charges are reflected as a redemption of units held by the contract owner. These are as follows:

| <u>Products</u> | <u>Annual Contract Charge</u> |
|--------------------------------------|--|
| Diversifier II/Optimizer | \$30 maximum |
| Commander | If Account Value is < \$100,000, the lesser of \$40 or 2% of the Account Value |
| Penn Freedom | If Account Value is < \$100,000, the lesser of \$40 or 2% of the Account Value |
| Enhanced Credit Variable Annuity | If Account Value is < \$100,000, the lesser of \$40 or 2% of the Account Value |
| Pennant Select | If Account Value is < \$100,000, the lesser of \$40 or 2% of the Account Value |
| Olympia XT Advisor | If Account Value is < \$100,000, the lesser of \$40 or 2% of the Account Value |
| Penn Freedom Advisor | If Account Value is < \$100,000, the lesser of \$40 or 2% of the Account Value |
| Retirement Planner VA | \$30 maximum |
| Inflation Protector Variable Annuity | If Account Value is < \$100,000, the lesser of \$40 or 2% of the Account Value |
| Smart Foundation Flex | If Account Value is < \$50,000, the lesser of \$40 or 2% of the Account Value |
| Smart Foundation Plus | If Account Value is < \$50,000, the lesser of \$40 or 2% of the Account Value |
| Smart Foundation VA | If Account Value is < \$50,000, the lesser of \$40 or 2% of the Account Value |

Note 4. Related Party Transactions and Contract Charges (continued)

| <u>Products</u> | <u>Surrender Charge</u> |
|--------------------------------------|--|
| Diversifier II/Optimizer | Maximum charge of 7% of purchase payments received. Charges do not apply after 10 years. |
| Commander | Maximum charge of 1% of purchase payments received. Charges do not apply after 1 year. |
| Penn Freedom | Maximum charge of 8% of purchase payments received. Charges do not apply after 4 years. |
| Enhanced Credit Variable Annuity | Maximum charge of 8% of purchase payments received. Charges do not apply after 9 years. |
| Pennant Select | Maximum charge of 7% of purchase payments received. Charges do not apply after 7 years. |
| Olympia XT Advisor | Maximum charge of 8% of purchase payments received. Charges do not apply after 9 years. |
| Penn Freedom Advisor | Maximum charge of 8% of purchase payments received. Charges do not apply after 4 years. |
| Retirement Planner VA | Maximum charge of 7% of purchase payments received. Charges do not apply after 10 years. |
| Inflation Protector Variable Annuity | Maximum charge of 8% of purchase payments received. Charges do not apply after 4 years. |
| Smart Foundation Flex | Maximum charge of 8% of purchase payments received. Charges do not apply after 4 years. |
| Smart Foundation Plus | Maximum charge of 8% of purchase payments received. Charges do not apply after 9 years. |
| Smart Foundation VA | Maximum charge of 8% of purchase payments received. Charges do not apply after 7 years. |

Premium taxes on purchase payments are withheld from payments prior to the purchase of units. Currently, state premium taxes on purchase payments range from 0.00% to 3.50%.

Note 5. Accumulation Units

The accumulation units are as follows:

| <u>Subaccount</u> | <u>December 31, 2015</u> | | | <u>December 31, 2014</u> | | |
|------------------------------------|--------------------------|-----------------------|----------------------------|--------------------------|-----------------------|----------------------------|
| | <u>Units Purchased</u> | <u>Units Redeemed</u> | <u>Ending Unit Balance</u> | <u>Units Purchased</u> | <u>Units Redeemed</u> | <u>Ending Unit Balance</u> |
| Money Market Fund | 4,908,222 | (5,664,326) | 7,165,609 | 8,146,231 | (7,178,732) | 7,921,693 |
| Limited Maturity Bond Fund | 2,454,666 | (2,835,371) | 7,915,881 | 2,496,856 | (1,587,016) | 8,296,587 |
| Quality Bond Fund | 1,741,076 | (1,590,349) | 18,214,747 | 1,484,602 | (2,459,100) | 18,064,025 |
| High Yield Bond Fund | 694,650 | (859,312) | 6,630,090 | 1,315,676 | (795,618) | 6,794,756 |
| Flexibly Managed Fund | 16,924,357 | (1,046,021) | 118,743,663 | 15,696,896 | (1,304,358) | 102,865,327 |
| Balanced Fund | 233,463 | (423,562) | 3,682,108 | 405,826 | (458,743) | 3,872,213 |
| Large Growth Stock Fund | 932,752 | (1,124,136) | 11,813,632 | 1,242,379 | (989,429) | 12,005,029 |
| Large Cap Growth Fund | 235,426 | (177,766) | 1,982,759 | 160,172 | (276,109) | 1,925,104 |
| Large Core Growth Fund | 128,210 | (553,038) | 3,829,385 | 211,903 | (480,239) | 4,254,224 |
| Large Cap Value Fund | 421,957 | (510,666) | 5,350,669 | 611,210 | (517,635) | 5,439,377 |
| Large Core Value Fund | 419,751 | (913,008) | 6,160,221 | 490,522 | (867,076) | 6,653,466 |
| Index 500 Fund | 1,168,418 | (982,536) | 13,616,761 | 1,668,900 | (824,706) | 13,430,873 |
| Mid Cap Growth Fund | 325,873 | (532,882) | 4,925,209 | 363,919 | (767,007) | 5,132,228 |
| Mid Cap Value Fund | 585,629 | (349,477) | 4,598,636 | 524,228 | (355,247) | 4,362,483 |
| Mid Core Value Fund | 183,678 | (482,233) | 2,113,222 | 383,717 | (247,846) | 2,411,786 |
| SMID Cap Growth Fund | 595,006 | (307,713) | 2,393,965 | 647,650 | (307,152) | 2,106,682 |
| SMID Cap Value Fund | 337,554 | (205,880) | 2,418,781 | 684,270 | (283,601) | 2,287,099 |
| Small Cap Growth Fund | 351,249 | (387,729) | 2,915,128 | 463,569 | (429,071) | 2,951,597 |
| Small Cap Value Fund | 578,815 | (348,136) | 5,386,678 | 774,928 | (382,994) | 5,155,973 |
| Small Cap Index Fund | 404,463 | (201,977) | 3,138,189 | 682,245 | (437,194) | 2,935,703 |
| Developed International Index Fund | 615,350 | (491,551) | 4,549,440 | 972,374 | (533,204) | 4,425,645 |

Note 5. Accumulation Units (continued)

| Subaccount | December 31, 2015 | | | December 31, 2014 | | |
|---|-------------------|----------------|---------------------|-------------------|----------------|---------------------|
| | Units Purchased | Units Redeemed | Ending Unit Balance | Units Purchased | Units Redeemed | Ending Unit Balance |
| International Equity Fund | 753,724 | (752,448) | 10,690,187 | 1,069,875 | (713,946) | 10,688,903 |
| Emerging Markets Equity Fund | 922,889 | (928,109) | 10,415,118 | 1,101,430 | (1,001,391) | 10,420,329 |
| Real Estate Securities Fund | 648,892 | (504,196) | 4,489,842 | 632,408 | (664,295) | 4,345,139 |
| Aggressive Allocation Fund | 460,537 | (505,893) | 4,226,885 | 715,883 | (415,518) | 4,272,252 |
| Moderately Aggressive Allocation Fund | 1,005,071 | (1,242,613) | 16,364,468 | 1,875,164 | (1,231,013) | 16,602,015 |
| Moderate Allocation Fund | 934,389 | (2,041,324) | 25,391,411 | 1,757,815 | (1,740,187) | 26,498,357 |
| Moderately Conservative Allocation Fund | 964,926 | (1,257,810) | 7,960,449 | 930,860 | (1,429,251) | 8,253,338 |
| Conservative Allocation Fund | 679,677 | (908,613) | 5,015,775 | 907,795 | (1,326,736) | 5,244,717 |
| High Income Bond Fund II | — | — | — | — | (36) | — |
| Financial Services Fund | — | — | — | — | — | — |
| Health Care Fund | — | — | — | — | — | — |
| Russell 2000 1.5x Strategy Fund | — | (2) | 1,095 | — | (4,873) | 1,097 |
| Nova Fund | — | (8,678) | — | 10,225 | (9,430) | 8,677 |
| NASDAQ-100 Fund | — | (6,243) | — | 6,241 | (4,187) | 6,241 |
| Technology Fund | 1,791 | (1,781) | — | — | — | — |
| Inverse S&P 500 Strategy Fund | — | — | — | — | — | — |
| Government Long Bond 1.2x Strategy Fund | 5,372 | (81) | 5,291 | 8,312 | (8,312) | — |
| U.S. Government Money Market Fund | — | (4) | 480 | 17,238 | (17,490) | 485 |
| Utilities Fund | — | — | — | — | — | — |
| Equity Income Portfolio II | 9,187 | (138) | 9,048 | — | (131) | — |
| International Stock Portfolio | 3,850 | (1,102) | 2,748 | — | (49) | — |

Note 6. Financial Highlights

Account III is a funding vehicle for a number of variable annuity products, which have unique combinations of features and fees that are charged against the contract owner's account balance. Differences in the fee structures result in a variety of unit values, expense ratios and total returns.

The following table was developed by determining which products offered within Account III have the lowest and highest total return. Only product designs within each subaccount that has units outstanding during the respective periods were considered when determining the lowest and highest total return. The summary may not reflect the minimum and maximum contract charges offered within Account III as contract owners may not have selected all available and applicable contract options.

| Subaccount | January 1, 2015 | | December 31, 2015 | | For the Year ended December 31, 2015 | | |
|----------------------------|-------------------|-------------|-------------------|---------------|--------------------------------------|--------------------|--------------------|
| | Unit Value | Units | Unit Value | Net Assets | Investment Income Ratio*(%) | Expense Ratio**(%) | Total Return***(%) |
| Money Market Fund | \$9.30 to \$23.10 | 7,165,609 | \$9.15 to \$22.81 | \$ 74,501,987 | 0.01 | 1.25 to 1.65 | (1.63) to (1.23) |
| Limited Maturity Bond Fund | 9.56 to 16.86 | 7,915,881 | 9.48 to 16.79 | 93,195,717 | — | 1.25 to 1.65 | (0.87) to (0.47) |
| Quality Bond Fund | 10.04 to 40.44 | 18,214,747 | 9.92 to 40.09 | 257,385,723 | — | 1.25 to 1.65 | (1.27) to (0.87) |
| High Yield Bond Fund | 11.88 to 83.14 | 6,630,090 | 11.29 to 79.34 | 117,344,185 | — | 1.25 to 1.65 | (4.95) to (4.57) |
| Flexibly Managed Fund | 14.80 to 249.59 | 118,743,663 | 15.29 to 258.80 | 2,924,695,781 | — | 1.25 to 1.65 | 3.28 to 3.69 |
| Balanced Fund | 13.34 to 15.51 | 3,682,108 | 13.21 to 15.42 | 54,348,189 | — | 1.25 to 1.65 | (0.97) to (0.57) |
| Large Growth Stock Fund | 10.87 to 74.95 | 11,813,632 | 11.84 to 81.80 | 194,780,086 | — | 1.25 to 1.65 | 8.70 to 9.14 |
| Large Cap Growth Fund | 12.89 to 15.07 | 1,982,759 | 12.68 to 14.80 | 26,051,679 | — | 1.25 to 1.65 | (1.79) to (1.39) |
| Large Core Growth Fund | 14.66 to 17.99 | 3,829,385 | 14.69 to 17.99 | 57,685,922 | — | 1.25 to 1.65 | 0.02 to 0.42 |
| Large Cap Value Fund | 15.69 to 77.66 | 5,350,669 | 14.76 to 73.36 | 110,316,051 | — | 1.25 to 1.65 | (5.92) to (5.54) |
| Large Core Value Fund | 13.72 to 16.49 | 6,160,221 | 13.41 to 16.09 | 85,427,687 | — | 1.25 to 1.65 | (2.43) to (2.04) |
| Index 500 Fund | 16.17 to 27.60 | 13,616,761 | 16.06 to 27.53 | 246,090,977 | — | 1.25 to 1.65 | (0.65) to (0.25) |
| Mid Cap Growth Fund | 12.12 to 26.52 | 4,925,209 | 11.26 to 24.68 | 70,123,961 | — | 1.25 to 1.65 | (7.32) to (6.95) |
| Mid Cap Value Fund | 16.76 to 42.71 | 4,598,636 | 15.17 to 38.81 | 104,959,167 | — | 1.25 to 1.65 | (9.49) to (9.13) |
| Mid Core Value Fund | 16.04 to 22.34 | 2,113,222 | 15.54 to 21.73 | 41,291,697 | — | 1.25 to 1.65 | (3.13) to (2.74) |
| SMID Cap Growth Fund | 15.64 to 18.25 | 2,393,965 | 15.15 to 17.75 | 39,718,070 | — | 1.25 to 1.65 | (3.13) to (2.74) |
| SMID Cap Value Fund | 16.83 to 19.41 | 2,418,781 | 15.61 to 18.08 | 41,074,325 | — | 1.25 to 1.65 | (7.24) to (6.86) |
| Small Cap Growth Fund | 11.77 to 36.16 | 2,915,128 | 11.64 to 35.83 | 50,955,125 | — | 1.25 to 1.65 | (1.29) to (0.90) |

Note 6. Financial Highlights (continued)

| Subaccount | January 1, 2015 | | December 31, 2015 | | For the Year ended December 31, 2015 | | |
|---|--------------------|------------|--------------------|----------------|--------------------------------------|--------------------|--------------------|
| | Unit Value | Units | Unit Value | Net Assets | Investment Income Ratio*(%) | Expense Ratio**(%) | Total Return***(%) |
| Small Cap Value Fund | \$16.27 to \$60.85 | 5,386,678 | \$15.13 to \$56.82 | \$ 149,823,984 | — | 1.25 to 1.65 | (7.01) to (6.63) |
| Small Cap Index Fund | 15.65 to 17.94 | 3,138,189 | 14.61 to 16.74 | 47,493,658 | — | 1.25 to 1.65 | (6.67) to (6.30) |
| Developed International Index Fund | 10.57 to 12.88 | 4,549,440 | 10.27 to 12.53 | 49,799,229 | — | 1.25 to 1.65 | (3.00) to (2.61) |
| International Equity Fund | 12.59 to 44.72 | 10,690,187 | 12.83 to 45.75 | 217,439,079 | — | 1.25 to 1.65 | 1.90 to 2.30 |
| Emerging Markets Equity Fund | 9.83 to 10.74 | 10,415,118 | 8.61 to 9.44 | 92,026,025 | — | 1.25 to 1.65 | (12.35) to (11.99) |
| Real Estate Securities Fund | 14.90 to 28.49 | 4,489,842 | 15.42 to 29.61 | 101,730,698 | — | 1.25 to 1.65 | 3.50 to 3.91 |
| Aggressive Allocation Fund | 14.01 to 15.32 | 4,226,885 | 13.59 to 14.83 | 58,825,685 | — | 1.25 to 1.65 | (3.20) to (2.81) |
| Moderately Aggressive Allocation Fund | 13.59 to 14.82 | 16,364,468 | 13.21 to 14.47 | 229,110,017 | — | 1.25 to 1.65 | (2.76) to (2.37) |
| Moderate Allocation Fund | 12.65 to 13.66 | 25,391,411 | 12.37 to 13.42 | 330,778,517 | — | 1.25 to 1.65 | (2.18) to (1.79) |
| Moderately Conservative Allocation Fund | 11.79 to 12.97 | 7,960,449 | 11.57 to 12.78 | 98,299,803 | — | 1.25 to 1.65 | (1.85) to (1.46) |
| Conservative Allocation Fund | 10.85 to 12.13 | 5,015,775 | 10.68 to 11.99 | 58,140,402 | — | 1.25 to 1.65 | (1.56) to (1.16) |
| High Income Bond Fund II | 21.71 to 22.27 | — | 20.82 to 21.39 | — | — | 1.40 to 1.60 | (4.12) to (3.93) |
| Financial Services Fund | 10.37 to 10.63 | — | 9.80 to 10.07 | — | — | 1.40 to 1.60 | (5.51) to (5.32) |
| Health Care Fund | 25.82 to 26.48 | — | 26.56 to 27.30 | — | — | 1.40 to 1.60 | 2.87 to 3.08 |
| Russell 2000 1.5x Strategy Fund | 19.41 to 19.90 | 1,095 | 17.37 to 17.85 | 19,011 | — | 1.40 to 1.60 | (10.52) to (10.34) |
| Nova Fund | 18.18 to 18.64 | — | 17.76 to 18.25 | — | — | 1.40 to 1.60 | (2.29) to (2.10) |
| NASDAQ-100 Fund | 25.06 to 25.70 | — | 26.69 to 27.43 | — | — | 1.40 to 1.60 | 6.52 to 6.74 |
| Technology Fund | 17.57 to 18.02 | — | 17.48 to 17.97 | — | — | 1.40 to 1.60 | (0.49) to (0.29) |
| Inverse S&P 500 Strategy Fund | 2.40 to 2.46 | — | 2.26 to 2.32 | — | — | 1.40 to 1.60 | (5.95) to (5.76) |
| Government Long Bond 1.2x Strategy Fund | 21.34 to 21.88 | 5,291 | 19.93 to 20.48 | 108,367 | 1.06 | 1.40 to 1.60 | (6.60) to (6.41) |
| U.S. Government Money Market Fund | 9.15 to 9.38 | 480 | 9.01 to 9.25 | 4,321 | — | 1.40 to 1.60 | (1.59) to (1.39) |
| Utilities Fund | 18.23 to 18.69 | — | 16.62 to 17.08 | — | — | 1.40 to 1.60 | (8.83) to (8.65) |
| Equity Income Portfolio II | 18.21 to 18.42 | 9,048 | 16.65 to 16.87 | 152,678 | 2.32 | 1.40 to 1.60 | (8.58) to (8.40) |
| International Stock Portfolio | 15.94 to 16.34 | 2,748 | 15.54 to 15.97 | 43,889 | 0.91 | 1.40 to 1.60 | (2.48) to (2.28) |

| Subaccount | January 1, 2014 | | December 31, 2014 | | For the Year ended December 31, 2014 | | |
|------------------------------------|-------------------|-------------|-------------------|---------------|--------------------------------------|--------------------|--------------------|
| | Unit Value | Units | Unit Value | Net Assets | Investment Income Ratio*(%) | Expense Ratio**(%) | Total Return***(%) |
| Money Market Fund | \$9.46 to \$23.38 | 7,921,693 | \$9.30 to \$23.10 | \$ 84,205,368 | 0.01 | 1.25 to 1.65 | (1.63) to (1.23) |
| Limited Maturity Bond Fund | 9.70 to 17.05 | 8,296,587 | 9.56 to 16.86 | 99,241,901 | — | 1.25 to 1.65 | (1.47) to (1.07) |
| Quality Bond Fund | 9.72 to 38.97 | 18,064,025 | 10.04 to 40.44 | 267,380,170 | — | 1.25 to 1.65 | 3.38 to 3.79 |
| High Yield Bond Fund | 11.86 to 82.66 | 6,794,756 | 11.88 to 83.14 | 130,586,100 | — | 1.25 to 1.65 | 0.19 to 0.59 |
| Flexibly Managed Fund | 13.42 to 225.40 | 102,865,327 | 14.80 to 249.59 | 2,675,763,880 | — | 1.25 to 1.65 | 10.29 to 10.73 |
| Balanced Fund | 12.37 to 14.32 | 3,872,213 | 13.34 to 15.51 | 57,974,055 | — | 1.25 to 1.65 | 7.86 to 8.29 |
| Large Growth Stock Fund | 10.17 to 70.04 | 12,005,029 | 10.87 to 74.95 | 179,666,252 | — | 1.25 to 1.65 | 6.59 to 7.02 |
| Large Cap Growth Fund | 11.75 to 13.77 | 1,925,104 | 12.89 to 15.07 | 25,559,973 | — | 1.25 to 1.65 | 9.47 to 9.91 |
| Large Core Growth Fund | 13.81 to 16.97 | 4,254,224 | 14.66 to 17.99 | 63,644,134 | — | 1.25 to 1.65 | 5.97 to 6.39 |
| Large Cap Value Fund | 14.33 to 70.65 | 5,439,377 | 15.69 to 77.66 | 122,055,628 | — | 1.25 to 1.65 | 9.49 to 9.93 |
| Large Core Value Fund | 12.51 to 15.06 | 6,653,466 | 13.72 to 16.49 | 93,653,609 | — | 1.25 to 1.65 | 9.46 to 9.90 |
| Index 500 Fund | 14.51 to 24.67 | 13,430,873 | 16.17 to 27.60 | 245,906,551 | — | 1.25 to 1.65 | 11.40 to 11.85 |
| Mid Cap Growth Fund | 11.22 to 24.53 | 5,132,228 | 12.12 to 26.52 | 78,166,078 | — | 1.25 to 1.65 | 7.70 to 8.13 |
| Mid Cap Value Fund | 14.99 to 38.05 | 4,362,483 | 16.76 to 42.71 | 116,883,765 | — | 1.25 to 1.65 | 11.81 to 12.26 |
| Mid Core Value Fund | 14.01 to 19.44 | 2,411,786 | 16.04 to 22.34 | 49,675,998 | — | 1.25 to 1.65 | 14.47 to 14.93 |
| SMID Cap Growth Fund | 15.80 to 18.37 | 2,106,682 | 15.64 to 18.25 | 36,346,943 | — | 1.25 to 1.65 | (1.04) to (0.64) |
| SMID Cap Value Fund | 15.66 to 17.99 | 2,287,099 | 16.83 to 19.41 | 42,139,410 | — | 1.25 to 1.65 | 7.46 to 7.89 |
| Small Cap Growth Fund | 11.07 to 33.95 | 2,951,597 | 11.77 to 36.16 | 53,215,549 | — | 1.25 to 1.65 | 6.07 to 6.50 |
| Small Cap Value Fund | 15.44 to 57.51 | 5,155,973 | 16.27 to 60.85 | 163,561,074 | — | 1.25 to 1.65 | 5.39 to 5.82 |
| Small Cap Index Fund | 15.27 to 17.50 | 2,935,703 | 15.65 to 17.94 | 47,586,006 | — | 1.25 to 1.65 | 2.50 to 2.91 |
| Developed International Index Fund | 11.42 to 13.92 | 4,425,645 | 10.57 to 12.88 | 49,365,626 | — | 1.25 to 1.65 | (7.64) to (7.27) |
| International Equity Fund | 12.44 to 43.98 | 10,688,903 | 12.59 to 44.72 | 220,667,570 | — | 1.25 to 1.65 | 1.26 to 1.67 |
| Emerging Markets Equity Fund | 10.51 to 11.45 | 10,420,329 | 9.83 to 10.74 | 104,566,513 | — | 1.25 to 1.65 | (6.47) to (6.09) |
| Real Estate Securities Fund | 11.63 to 22.15 | 4,345,139 | 14.90 to 28.49 | 98,707,472 | — | 1.25 to 1.65 | 28.10 to 28.61 |
| Aggressive Allocation Fund | 13.31 to 14.59 | 4,272,252 | 14.01 to 15.32 | 61,333,257 | — | 1.25 to 1.65 | 5.03 to 5.45 |

Note 6. Financial Highlights (continued)

| Subaccount | January 1, 2014 | | December 31, 2014 | | For the Year ended December 31, 2014 | | |
|---|--------------------|------------|--------------------|----------------|--------------------------------------|--------------------|--------------------|
| | Unit Value | Units | Unit Value | Net Assets | Investment Income Ratio*(%) | Expense Ratio**(%) | Total Return***(%) |
| Moderately Aggressive Allocation Fund | \$13.00 to \$14.12 | 16,602,015 | \$13.59 to \$14.82 | \$ 239,600,535 | — | 1.25 to 1.65 | 4.54 to 4.96 |
| Moderate Allocation Fund | 12.17 to 13.10 | 26,498,357 | 12.65 to 13.66 | 353,318,651 | — | 1.25 to 1.65 | 3.90 to 4.32 |
| Moderately Conservative Allocation Fund | 11.41 to 12.50 | 8,253,338 | 11.79 to 12.97 | 104,042,468 | — | 1.25 to 1.65 | 3.29 to 3.70 |
| Conservative Allocation Fund | 10.63 to 11.84 | 5,244,717 | 10.85 to 12.13 | 61,856,797 | — | 1.25 to 1.65 | 2.05 to 2.46 |
| High Income Bond Fund II | 21.49 to 21.99 | — | 21.71 to 22.27 | — | — | 1.40 to 1.60 | 1.06 to 1.26 |
| Financial Services Fund | 9.36 to 9.58 | — | 10.37 to 10.63 | — | — | 1.40 to 1.60 | 10.79 to 11.01 |
| Health Care Fund | 21.06 to 21.55 | — | 25.82 to 26.48 | — | — | 1.40 to 1.60 | 22.64 to 22.89 |
| Russell 2000 1.5x Strategy Fund | 18.91 to 19.36 | 1,097 | 19.41 to 19.90 | 21,285 | — | 1.40 to 1.60 | 2.63 to 2.84 |
| Nova Fund | 15.57 to 15.94 | 8,677 | 18.18 to 18.64 | 161,737 | — | 1.40 to 1.60 | 16.70 to 16.94 |
| NASDAQ-100 Fund | 21.68 to 22.19 | 6,241 | 25.06 to 25.70 | 160,407 | — | 1.40 to 1.60 | 15.58 to 15.81 |
| Technology Fund | 16.22 to 16.60 | — | 17.57 to 18.02 | — | — | 1.40 to 1.60 | 8.34 to 8.55 |
| Inverse S&P 500 Strategy Fund | 2.85 to 2.92 | — | 2.40 to 2.46 | — | — | 1.40 to 1.60 | (15.81) to (15.64) |
| Government Long Bond 1.2x Strategy Fund | 16.10 to 16.48 | — | 21.34 to 21.88 | — | 0.90 | 1.40 to 1.60 | 32.54 to 32.80 |
| U.S. Government Money Market Fund | 9.30 to 9.52 | 485 | 9.15 to 9.38 | 4,434 | — | 1.40 to 1.60 | (1.59) to (1.39) |
| Utilities Fund | 15.07 to 15.42 | — | 18.23 to 18.69 | — | — | 1.40 to 1.60 | 20.94 to 21.19 |
| Equity Income Portfolio II | 17.28 to 17.44 | — | 18.21 to 18.42 | — | — | 1.40 to 1.60 | 5.40 to 5.61 |
| International Stock Portfolio | 16.40 to 16.78 | — | 15.94 to 16.34 | — | — | 1.40 to 1.60 | (2.81) to (2.61) |

| Subaccount | January 1, 2013 | | December 31, 2013 | | For the Year ended December 31, 2013 | | |
|---|-------------------|------------|-------------------|---------------|--------------------------------------|--------------------|--------------------|
| | Unit Value | Units | Unit Value | Net Assets | Investment Income Ratio*(%) | Expense Ratio**(%) | Total Return***(%) |
| Money Market Fund | \$9.62 to \$23.68 | 6,954,194 | \$9.46 to \$23.38 | \$ 76,956,135 | 0.01 | 1.25 to 1.65 | (1.63) to (1.23) |
| Limited Maturity Bond Fund | 9.87 to 17.28 | 7,386,747 | 9.70 to 17.05 | 90,783,913 | — | 1.25 to 1.65 | (1.72) to (1.33) |
| Quality Bond Fund | 10.85 to 40.66 | 19,038,523 | 9.72 to 38.97 | 282,321,370 | — | 1.25 to 1.65 | (4.56) to (4.17) |
| High Yield Bond Fund | 12.00 to 77.56 | 6,274,698 | 11.86 to 82.66 | 129,687,090 | — | 1.25 to 1.65 | 6.14 to 6.57 |
| Flexibly Managed Fund | 12.54 to 186.64 | 88,472,789 | 13.42 to 225.40 | 2,307,823,488 | — | 1.25 to 1.65 | 20.29 to 20.77 |
| Balanced Fund | 12.05 to 12.42 | 3,925,130 | 12.37 to 14.32 | 54,699,169 | — | 1.25 to 1.65 | 14.84 to 15.30 |
| Large Growth Stock Fund | 7.41 to 50.98 | 11,752,079 | 10.17 to 70.04 | 161,971,873 | — | 1.25 to 1.65 | 36.84 to 37.39 |
| Large Cap Growth Fund | 9.68 to 11.37 | 2,041,041 | 11.75 to 13.77 | 24,532,544 | — | 1.25 to 1.65 | 21.08 to 21.56 |
| Large Core Growth Fund | 10.16 to 12.51 | 4,522,560 | 13.81 to 16.97 | 63,350,383 | — | 1.25 to 1.65 | 35.65 to 36.19 |
| Large Cap Value Fund | 11.85 to 53.70 | 5,345,802 | 14.33 to 70.65 | 112,888,785 | — | 1.25 to 1.65 | 31.03 to 31.55 |
| Large Core Value Fund | 9.78 to 11.80 | 7,030,020 | 12.51 to 15.06 | 89,601,755 | — | 1.25 to 1.65 | 27.65 to 28.17 |
| Index 500 Fund | 12.06 to 18.95 | 12,586,679 | 14.51 to 24.67 | 208,588,587 | — | 1.25 to 1.65 | 29.71 to 30.23 |
| Mid Cap Growth Fund | 8.32 to 18.17 | 5,535,316 | 11.22 to 24.53 | 77,594,155 | — | 1.25 to 1.65 | 34.48 to 35.02 |
| Mid Cap Value Fund | 12.20 to 28.29 | 4,193,502 | 14.99 to 38.05 | 106,660,713 | — | 1.25 to 1.65 | 33.98 to 34.51 |
| Mid Core Value Fund | 12.59 to 15.24 | 2,275,915 | 14.01 to 19.44 | 41,597,269 | — | 1.25 to 1.65 | 27.04 to 27.55 |
| SMID Cap Growth Fund | 12.70 to 13.02 | 1,766,184 | 15.80 to 18.37 | 31,138,018 | — | 1.25 to 1.65 | 40.50 to 41.06 |
| SMID Cap Value Fund | 12.54 to 13.20 | 1,886,430 | 15.66 to 17.99 | 32,550,681 | — | 1.25 to 1.65 | 35.74 to 36.28 |
| Small Cap Growth Fund | 8.16 to 24.98 | 2,917,099 | 11.07 to 33.95 | 51,089,120 | — | 1.25 to 1.65 | 35.35 to 35.90 |
| Small Cap Value Fund | 13.41 to 41.91 | 4,764,039 | 15.44 to 57.51 | 156,251,206 | — | 1.25 to 1.65 | 36.66 to 37.20 |
| Small Cap Index Fund | 11.54 to 12.88 | 2,690,652 | 15.27 to 17.50 | 42,520,607 | — | 1.25 to 1.65 | 35.88 to 36.42 |
| Developed International Index Fund | 9.57 to 10.88 | 3,986,475 | 11.42 to 13.92 | 47,446,590 | — | 1.25 to 1.65 | 19.10 to 19.58 |
| International Equity Fund | 12.87 to 42.03 | 10,332,974 | 12.44 to 43.98 | 219,057,521 | — | 1.25 to 1.65 | 4.24 to 4.65 |
| Emerging Markets Equity Fund | 10.80 to 10.96 | 10,320,290 | 10.51 to 11.45 | 110,201,487 | — | 1.25 to 1.65 | (2.75) to (2.36) |
| Real Estate Securities Fund | 12.89 to 21.75 | 4,377,026 | 11.63 to 22.15 | 81,177,328 | — | 1.25 to 1.65 | 1.44 to 1.85 |
| Aggressive Allocation Fund | 11.03 to 12.11 | 3,971,887 | 13.31 to 14.59 | 54,093,458 | — | 1.25 to 1.65 | 20.49 to 20.97 |
| Moderately Aggressive Allocation Fund | 11.90 to 12.00 | 15,957,864 | 13.00 to 14.12 | 220,885,284 | — | 1.25 to 1.65 | 17.21 to 17.68 |
| Moderate Allocation Fund | 11.52 to 11.63 | 26,480,729 | 12.17 to 13.10 | 340,334,339 | — | 1.25 to 1.65 | 12.24 to 12.69 |
| Moderately Conservative Allocation Fund | 11.28 to 11.58 | 8,751,729 | 11.41 to 12.50 | 107,070,466 | — | 1.25 to 1.65 | 7.56 to 7.99 |
| Conservative Allocation Fund | 10.81 to 11.48 | 5,663,658 | 10.63 to 11.84 | 65,545,737 | — | 1.25 to 1.65 | 2.72 to 3.13 |
| High Income Bond Fund II | 20.41 to 20.84 | 36 | 21.49 to 21.99 | 785 | 19.02 | 1.40 to 1.60 | 5.29 to 5.50 |
| Financial Services Fund | 7.46 to 7.62 | — | 9.36 to 9.58 | — | — | 1.40 to 1.60 | 25.53 to 25.78 |

Note 6. Financial Highlights (continued)

| Subaccount | January 1, 2013 | | December 31, 2013 | | For the Year ended December 31, 2013 | | |
|---|---------------------|-------|---------------------|------------|--------------------------------------|--------------------|--------------------|
| | Unit Value | Units | Unit Value | Net Assets | Investment Income Ratio*(%) | Expense Ratio**(%) | Total Return***(%) |
| Health Care Fund | \$ 15.09 to \$15.41 | — | \$ 21.06 to \$21.55 | \$ — | — | 1.40 to 1.60 | 39.56 to 39.84 |
| Russell 2000 1.5x Strategy Fund | 12.12 to 12.38 | 5,970 | 18.91 to 19.36 | 115,066 | — | 1.40 to 1.60 | 56.05 to 56.36 |
| Nova Fund | 10.62 to 10.85 | 7,882 | 15.57 to 15.94 | 125,652 | 0.06 | 1.40 to 1.60 | 46.63 to 46.92 |
| NASDAQ-100 Fund | 16.37 to 16.72 | 4,187 | 21.68 to 22.19 | 92,916 | — | 1.40 to 1.60 | 32.48 to 32.75 |
| Technology Fund | 12.17 to 12.43 | — | 16.22 to 16.60 | — | — | 1.40 to 1.60 | 33.25 to 33.51 |
| Inverse S&P 500 Strategy Fund | 3.94 to 4.03 | — | 2.85 to 2.92 | — | — | 1.40 to 1.60 | (27.68) to (27.54) |
| Government Long Bond 1.2x Strategy Fund | 20.01 to 20.44 | — | 16.10 to 16.48 | — | 0.93 | 1.40 to 1.60 | (19.55) to (19.39) |
| U.S. Government Money Market Fund | 9.45 to 9.65 | 737 | 9.30 to 9.52 | 6,850 | — | 1.40 to 1.60 | (1.59) to (1.39) |
| Utilities Fund | 13.48 to 13.77 | — | 15.07 to 15.42 | — | — | 1.40 to 1.60 | 11.82 to 12.05 |
| Equity Income Portfolio II | 13.57 to 13.67 | 131 | 17.28 to 17.44 | 2,290 | 1.18 | 1.40 to 1.60 | 27.35 to 27.61 |
| International Stock Portfolio | 14.61 to 14.92 | 49 | 16.40 to 16.78 | 26 | 0.26 | 1.40 to 1.60 | 12.24 to 12.47 |

| Subaccount | January 1, 2012 | | December 31, 2012 | | For the Year ended December 31, 2012 | | |
|---|-------------------|------------|-------------------|---------------|--------------------------------------|--------------------|---------------------|
| | Unit Value | Units | Unit Value | Net Assets | Investment Income Ratio*(%) | Expense Ratio**(%) | Total Return*** (%) |
| Money Market Fund | \$9.77 to \$23.97 | 7,463,821 | \$9.62 to \$23.68 | \$ 85,893,038 | 0.01 | 1.25 to 1.65 | (1.63) to (1.24) |
| Limited Maturity Bond Fund | 9.97 to 17.39 | 8,575,064 | 9.87 to 17.28 | 109,915,517 | — | 1.25 to 1.65 | (1.04) to (0.64) |
| Quality Bond Fund | 10.69 to 39.89 | 21,533,421 | 10.85 to 40.66 | 351,966,131 | — | 1.25 to 1.65 | 1.53 to 1.94 |
| High Yield Bond Fund | 10.65 to 68.56 | 5,722,084 | 12.00 to 77.56 | 122,606,185 | — | 1.25 to 1.65 | 12.69 to 13.14 |
| Flexibly Managed Fund | 11.11 to 164.73 | 65,569,130 | 12.54 to 186.64 | 1,686,424,294 | — | 1.25 to 1.65 | 12.85 to 13.30 |
| Balanced Fund | 11.09 to 11.38 | 3,997,849 | 12.05 to 12.42 | 49,006,232 | — | 1.25 to 1.65 | 8.71 to 9.15 |
| Large Growth Stock Fund | 6.33 to 43.47 | 11,667,980 | 7.41 to 50.98 | 114,823,851 | — | 1.25 to 1.65 | 16.80 to 17.27 |
| Large Cap Growth Fund | 8.91 to 10.49 | 2,313,656 | 9.68 to 11.37 | 22,682,554 | — | 1.25 to 1.65 | 8.45 to 8.88 |
| Large Core Growth Fund | 8.87 to 10.95 | 4,718,207 | 10.16 to 12.51 | 48,302,707 | — | 1.25 to 1.65 | 14.24 to 14.70 |
| Large Cap Value Fund | 10.64 to 48.03 | 5,389,501 | 11.85 to 53.70 | 89,619,920 | — | 1.25 to 1.65 | 11.37 to 11.82 |
| Large Core Value Fund | 8.58 to 10.38 | 7,275,639 | 9.78 to 11.80 | 71,773,984 | — | 1.25 to 1.65 | 13.69 to 14.14 |
| Index 500 Fund | 10.57 to 16.59 | 10,763,342 | 12.06 to 18.95 | 139,074,740 | — | 1.25 to 1.65 | 13.78 to 14.24 |
| Mid Cap Growth Fund | 7.96 to 17.34 | 5,882,908 | 8.32 to 18.17 | 61,374,541 | — | 1.25 to 1.65 | 4.34 to 4.76 |
| Mid Cap Value Fund | 10.77 to 24.87 | 3,645,551 | 12.20 to 28.29 | 75,251,634 | — | 1.25 to 1.65 | 13.28 to 13.74 |
| Mid Core Value Fund | 11.19 to 13.48 | 2,171,573 | 12.59 to 15.24 | 31,985,042 | — | 1.25 to 1.65 | 12.59 to 13.04 |
| SMID Cap Growth Fund | 11.19 to 11.43 | 1,343,033 | 12.70 to 13.02 | 17,151,936 | — | 1.25 to 1.65 | 13.46 to 13.92 |
| SMID Cap Value Fund | 10.72 to 11.24 | 1,419,281 | 12.54 to 13.20 | 18,326,726 | — | 1.25 to 1.65 | 17.00 to 17.47 |
| Small Cap Growth Fund | 7.83 to 23.93 | 3,503,870 | 8.16 to 24.98 | 45,235,245 | — | 1.25 to 1.65 | 3.99 to 4.41 |
| Small Cap Value Fund | 11.74 to 36.54 | 4,261,738 | 13.41 to 41.91 | 111,488,504 | — | 1.25 to 1.65 | 14.26 to 14.72 |
| Small Cap Index Fund | 10.14 to 11.34 | 2,059,654 | 11.54 to 12.88 | 23,927,683 | — | 1.25 to 1.65 | 13.61 to 14.06 |
| Developed International Index Fund | 8.22 to 9.36 | 3,437,294 | 9.57 to 10.88 | 33,573,279 | — | 1.25 to 1.65 | 16.22 to 16.69 |
| International Equity Fund | 10.80 to 35.15 | 9,339,249 | 12.87 to 42.03 | 199,916,772 | — | 1.25 to 1.65 | 19.08 to 19.56 |
| Emerging Markets Equity Fund | 9.18 to 9.28 | 9,450,596 | 10.80 to 10.96 | 103,129,950 | — | 1.25 to 1.65 | 17.64 to 18.12 |
| Real Estate Securities Fund | 11.30 to 18.99 | 3,523,145 | 12.89 to 21.75 | 69,490,415 | — | 1.25 to 1.65 | 14.10 to 14.56 |
| Aggressive Allocation Fund | 9.69 to 10.66 | 3,540,988 | 11.03 to 12.11 | 39,777,470 | — | 1.25 to 1.65 | 13.59 to 14.05 |
| Moderately Aggressive Allocation Fund | 10.62 to 10.69 | 14,347,637 | 11.90 to 12.00 | 170,342,103 | — | 1.25 to 1.65 | 11.77 to 12.22 |
| Moderate Allocation Fund | 10.54 to 10.66 | 24,530,823 | 11.52 to 11.63 | 282,076,195 | — | 1.25 to 1.65 | 9.11 to 9.54 |
| Moderately Conservative Allocation Fund | 10.58 to 10.83 | 8,113,565 | 11.28 to 11.58 | 92,878,552 | — | 1.25 to 1.65 | 6.53 to 6.95 |
| Conservative Allocation Fund | 10.42 to 11.02 | 6,104,689 | 10.81 to 11.48 | 69,099,125 | — | 1.25 to 1.65 | 3.75 to 4.17 |
| High Income Bond Fund II | 18.08 to 18.43 | 4,615 | 20.41 to 20.84 | 94,339 | 8.30 | 1.40 to 1.60 | 12.87 to 13.10 |
| Financial Services Fund | 6.18 to 6.30 | — | 7.46 to 7.62 | — | — | 1.40 to 1.60 | 20.73 to 20.97 |
| Health Care Fund | 13.09 to 13.34 | — | 15.09 to 15.41 | — | — | 1.40 to 1.60 | 15.30 to 15.53 |
| Russell 2000 1.5x Strategy Fund | 10.09 to 10.28 | 7,788 | 12.12 to 12.38 | 99,116 | — | 1.40 to 1.60 | 20.16 to 20.40 |
| Nova Fund | 8.83 to 9.00 | 7,755 | 10.62 to 10.85 | 84,139 | — | 1.40 to 1.60 | 20.30 to 20.54 |
| NASDAQ-100 Fund | 14.24 to 14.52 | 6,235 | 16.37 to 16.72 | 104,228 | — | 1.40 to 1.60 | 14.91 to 15.14 |
| Technology Fund | 11.05 to 11.26 | — | 12.17 to 12.43 | — | — | 1.40 to 1.60 | 10.20 to 10.42 |
| Inverse S&P 500 Strategy Fund | 4.83 to 4.92 | — | 3.94 to 4.03 | — | — | 1.40 to 1.60 | (18.30) to (18.14) |
| Government Long Bond 1.2x Strategy Fund | 19.74 to 20.12 | — | 20.01 to 20.44 | — | 0.88 | 1.40 to 1.60 | 1.38 to 1.58 |

Note 6. Financial Highlights (continued)

| Subaccount | January 1, 2012 | | December 31, 2012 | | For the Year ended December 31, 2012 | | |
|-----------------------------------|------------------|-------|-------------------|------------|--------------------------------------|--------------------|---------------------|
| | Unit Value | Units | Unit Value | Net Assets | Investment Income Ratio*(%) | Expense Ratio**(%) | Total Return*** (%) |
| U.S. Government Money Market Fund | \$9.60 to \$9.79 | 745 | \$9.45 to \$9.65 | \$ 7,044 | — | 1.40 to 1.60 | (1.59) to (1.39) |
| Utilities Fund | 13.54 to 13.81 | — | 13.48 to 13.77 | — | — | 1.40 to 1.60 | (0.49) to (0.29) |
| Equity Income Portfolio II | 11.79 to 11.85 | 1,387 | 13.57 to 13.67 | 18,956 | 1.68 | 1.40 to 1.60 | 15.06 to 15.29 |
| International Stock Portfolio | 12.53 to 12.78 | 520 | 14.61 to 14.92 | 7,764 | 0.90 | 1.40 to 1.60 | 16.55 to 16.79 |

| Subaccount | January 1, 2011 | | December 31, 2011 | | For the Year ended December 31, 2011 | | |
|---|-------------------|------------|-------------------|---------------|--------------------------------------|--------------------|---------------------|
| | Unit Value | Units | Unit Value | Net Assets | Investment Income Ratio*(%) | Expense Ratio**(%) | Total Return*** (%) |
| Money Market Fund | \$9.94 to \$24.27 | 8,560,787 | \$9.77 to \$23.97 | \$ 98,595,231 | 0.01 | 1.25 to 1.65 | (1.62) to (1.23) |
| Limited Maturity Bond Fund | 9.92 to 17.22 | 7,142,313 | 9.97 to 17.39 | 93,891,948 | — | 1.25 to 1.65 | 0.57 to 0.97 |
| Quality Bond Fund | 9.87 to 36.68 | 16,837,645 | 10.69 to 39.89 | 286,570,584 | — | 1.25 to 1.65 | 8.32 to 8.76 |
| High Yield Bond Fund | 10.51 to 67.35 | 4,597,551 | 10.65 to 68.56 | 95,196,769 | — | 1.25 to 1.65 | 1.39 to 1.80 |
| Flexibly Managed Fund | 10.96 to 161.88 | 52,675,864 | 11.11 to 164.73 | 1,364,848,230 | — | 1.25 to 1.65 | 1.35 to 1.76 |
| Balanced Fund | 10.68 to 10.92 | 3,756,492 | 11.09 to 11.38 | 42,562,623 | — | 1.25 to 1.65 | 3.83 to 4.25 |
| Large Growth Stock Fund | 6.52 to 44.71 | 11,560,527 | 6.33 to 43.47 | 96,768,806 | — | 1.25 to 1.65 | (3.16) to (2.77) |
| Large Cap Growth Fund | 9.70 to 11.43 | 2,408,580 | 8.91 to 10.49 | 21,612,432 | — | 1.25 to 1.65 | (8.29) to (7.92) |
| Large Core Growth Fund | 9.48 to 11.72 | 5,172,242 | 8.87 to 10.95 | 46,121,275 | — | 1.25 to 1.65 | (6.56) to (6.19) |
| Large Cap Value Fund | 11.32 to 50.88 | 5,761,980 | 10.64 to 48.03 | 87,153,415 | — | 1.25 to 1.65 | (5.98) to (5.61) |
| Large Core Value Fund | 9.09 to 11.01 | 7,644,718 | 8.58 to 10.38 | 65,894,581 | — | 1.25 to 1.65 | (5.75) to (5.38) |
| Index 500 Fund | 10.54 to 16.50 | 9,445,038 | 10.57 to 16.59 | 108,326,551 | — | 1.25 to 1.65 | 0.10 to 0.50 |
| Mid Cap Growth Fund | 8.75 to 19.04 | 5,841,085 | 7.96 to 17.34 | 57,659,326 | — | 1.25 to 1.65 | (9.28) to (8.92) |
| Mid Cap Value Fund | 11.68 to 26.87 | 3,480,795 | 10.77 to 24.87 | 66,324,565 | — | 1.25 to 1.65 | (7.81) to (7.44) |
| Mid Core Value Fund | 11.79 to 14.15 | 2,213,502 | 11.19 to 13.48 | 29,326,711 | — | 1.25 to 1.65 | (5.11) to (4.73) |
| SMID Cap Growth Fund | 11.94 to 12.15 | 963,998 | 11.19 to 11.43 | 10,950,785 | — | 1.25 to 1.65 | (6.27) to (5.90) |
| SMID Cap Value Fund | 11.74 to 12.26 | 1,168,734 | 10.72 to 11.24 | 13,032,095 | — | 1.25 to 1.65 | (8.68) to (8.32) |
| Small Cap Growth Fund | 8.94 to 27.26 | 3,481,729 | 7.83 to 23.93 | 44,044,123 | — | 1.25 to 1.65 | (12.56) to (12.21) |
| Small Cap Value Fund | 11.83 to 36.68 | 4,076,165 | 11.74 to 36.54 | 98,986,877 | — | 1.25 to 1.65 | (0.78) to (0.38) |
| Small Cap Index Fund | 10.77 to 12.07 | 1,571,097 | 10.14 to 11.34 | 15,997,508 | — | 1.25 to 1.65 | (6.07) to (5.70) |
| Developed International Index Fund | 9.54 to 10.89 | 2,873,026 | 8.22 to 9.36 | 23,689,661 | — | 1.25 to 1.65 | (14.04) to (13.70) |
| International Equity Fund | 10.88 to 35.27 | 9,403,367 | 10.80 to 35.15 | 173,169,647 | — | 1.25 to 1.65 | (0.74) to (0.34) |
| Emerging Markets Equity Fund | 11.45 to 11.52 | 8,776,569 | 9.18 to 9.28 | 81,050,617 | — | 1.25 to 1.65 | (19.78) to (19.46) |
| Real Estate Securities Fund(a) | 10.73 to 17.96 | 2,838,281 | 11.30 to 18.99 | 52,353,197 | — | 1.25 to 1.65 | 5.29 to 5.71 |
| Aggressive Allocation Fund | 10.20 to 11.25 | 2,760,819 | 9.69 to 10.66 | 26,876,020 | — | 1.25 to 1.65 | (5.23) to (4.85) |
| Moderately Aggressive Allocation Fund | 10.98 to 11.05 | 11,945,878 | 10.62 to 10.69 | 127,117,311 | — | 1.25 to 1.65 | (3.40) to (3.01) |
| Moderate Allocation Fund | 10.62 to 10.77 | 20,556,709 | 10.54 to 10.66 | 217,069,283 | — | 1.25 to 1.65 | (0.99) to (0.60) |
| Moderately Conservative Allocation Fund | 10.48 to 10.67 | 7,972,110 | 10.58 to 10.83 | 85,783,809 | — | 1.25 to 1.65 | 1.04 to 1.45 |
| Conservative Allocation Fund | 10.19 to 10.74 | 5,624,913 | 10.42 to 11.02 | 61,531,917 | — | 1.25 to 1.65 | 2.23 to 2.63 |
| V.I. Capital Appreciation Fund | 10.12 to 10.30 | — | 9.17 to 9.35 | — | 0.35 | 1.40 to 1.60 | (9.17) to (9.35) |
| High Income Bond Fund II | 17.47 to 17.77 | 9,158 | 18.08 to 18.43 | 167,160 | 8.08 | 1.40 to 1.60 | 3.50 to 3.71 |
| Financial Services Fund | 7.38 to 7.50 | — | 6.18 to 6.30 | — | — | 1.40 to 1.60 | (16.27) to (16.11) |
| Health Care Fund | 12.70 to 12.92 | — | 13.09 to 13.34 | — | — | 1.40 to 1.60 | 3.03 to 3.24 |
| Russell 2000 1.5x Strategy Fund | 11.67 to 11.87 | 1,104 | 10.09 to 10.28 | 11,134 | — | 1.40 to 1.60 | (13.58) to (13.40) |
| Nova Fund | 9.08 to 9.24 | 2,147 | 8.83 to 9.00 | 19,326 | 0.01 | 1.40 to 1.60 | (2.73) to (2.54) |
| NASDAQ-100 Fund | 14.16 to 14.41 | 10,993 | 14.24 to 14.52 | 159,591 | — | 1.40 to 1.60 | 0.55 to 0.75 |
| Technology Fund | 12.36 to 12.58 | — | 11.05 to 11.26 | — | — | 1.40 to 1.60 | (10.64) to (10.46) |
| Inverse S&P 500 Strategy Fund | 5.39 to 5.49 | 182 | 4.83 to 4.92 | 880 | — | 1.40 to 1.60 | (10.48) to (10.31) |
| Government Long Bond 1.2x Strategy Fund | 14.17 to 14.42 | 602 | 19.74 to 20.12 | 12,122 | 1.87 | 1.40 to 1.60 | 39.28 to 39.56 |
| U.S. Government Money Market Fund | 9.75 to 9.92 | 23,460 | 9.60 to 9.79 | 228,582 | — | 1.40 to 1.60 | (1.58) to (1.38) |
| Utilities Fund | 11.83 to 12.04 | — | 13.54 to 13.81 | — | — | 1.40 to 1.60 | 14.45 to 14.68 |
| Equity Income Portfolio II | 12.10 to 12.15 | 3,842 | 11.79 to 11.85 | 45,543 | 1.42 | 1.40 to 1.60 | (2.59) to (2.39) |
| International Stock Portfolio | 14.61 to 14.86 | 1,076 | 12.53 to 12.78 | 13,751 | 0.56 | 1.40 to 1.60 | (14.22) to (14.04) |

Note 6. Financial Highlights (continued)

(a) Prior to May 1, 2011, Real Estate Securities Fund was named REIT Fund.

* These ratios represent the dividends, excluding distributions of capital gains, received by the subaccounts within Account III from the underlying mutual fund, net of management fees and expenses assessed by the fund manager, divided by the average net assets of the respective subaccounts. These ratios exclude those expenses, such as mortality and expense charges, that result in direct reduction in the unit values. The recognition of investment income by the subaccount is affected by the timing of the declaration of dividends by the underlying funds in which the subaccount invests and, to the extent the underlying fund utilizes consent dividend rather than paying dividends in cash or reinvested shares, Account III does not record investment income.

** These ratios represent the annualized contract expenses of the subaccount, consisting primarily of mortality and expense charges, for each period indicated. The ratios include only those expenses that result in a direct reduction to unit values. Charges made directly to contract owner accounts through the redemption of units and expenses of the underlying subaccount are excluded. Certain previously disclosed expense ratios were changed according to the revisions stated in Footnote 2.

*** These ratios represent the total return for the periods indicated, including changes in the value of the underlying subaccount, and reflect deductions for all items included in the expense ratio. The total return does not include any expenses assessed through the redemption of units; inclusion of these expenses in the calculation would result in a reduction in the total return presented. Investment options with a date notation indicate the effective date of that investment option in the variable account. The total return is calculated for the period indicated or from the effective date through the end of the reporting period and reflects a range of actual product total returns.

Note 7. Subsequent Events

Management has evaluated events subsequent to December 31, 2015 and through the Account III Financial Statement date of issuance of April 1, 2016 and has determined that there were no subsequent events requiring recognition of disclosure in the financial statements.



The Penn Mutual Life Insurance Company



2015 Statutory Financial Statements



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Independent Auditor's Report

To the Board of Trustees of
The Penn Mutual Life Insurance Company:

We have audited the accompanying statutory financial statements of The Penn Mutual Life Insurance Company (the "Company"), which comprise the statutory statements of admitted assets, liabilities and surplus as of December 31, 2015 and 2014, and the related statutory statements of income and changes in surplus and cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the accounting practices prescribed or permitted by the Insurance Department of the Commonwealth of Pennsylvania. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 1 to the financial statements, the financial statements are prepared by the Company on the basis of the accounting practices prescribed or permitted by the Insurance Department of the Commonwealth of Pennsylvania, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

The effects on the financial statements of the variances between the statutory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the “Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles” paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the Company as of December 31, 2015 and 2014, or the results of its operations or its cash flows for the years then ended.

Opinion on Statutory Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and surplus of the Company as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended, in accordance with the accounting practices prescribed or permitted by the Insurance Department of the Commonwealth of Pennsylvania described in Note 1.

A handwritten signature in cursive script, appearing to read "PricewaterhouseCoopers USA".

February 16, 2016

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(In Thousands)

Statements of Admitted Assets, Liabilities and Surplus

| As of December 31, | 2015 | 2014 |
|--|---------------------|---------------------|
| ADMITTED ASSETS | | |
| Bonds | \$ 8,134,957 | \$ 7,528,488 |
| Stocks: | | |
| Preferred | 72,595 | 72,905 |
| Common — affiliated | 372,588 | 427,122 |
| Common — unaffiliated | 96,007 | 69,196 |
| Real estate | 29,444 | 27,642 |
| Policy loans | 304,727 | 298,689 |
| Cash and short-term investments | 245,071 | 128,700 |
| Alternative assets | 450,237 | 398,068 |
| Other invested assets | 481,160 | 458,024 |
| TOTAL INVESTMENTS | 10,186,786 | 9,408,834 |
| Investment income due and accrued | 107,540 | 99,001 |
| Premiums due and deferred | 69,796 | 63,551 |
| Deferred tax asset | 230,679 | 230,151 |
| Corporate owned life insurance | 207,641 | 214,623 |
| Amounts recoverable from reinsurers | 35,648 | 13,116 |
| Other assets | 179,120 | 62,422 |
| Separate account assets | 7,217,838 | 7,179,068 |
| TOTAL ASSETS | \$18,235,048 | \$17,270,766 |
| LIABILITIES | | |
| Reserves and funds for payment of insurance and annuity benefits | \$ 7,925,692 | \$ 7,106,140 |
| Dividends to policyholders payable in the following year | 48,290 | 41,667 |
| Policy claims in process | 45,028 | 44,000 |
| Interest maintenance reserve | 132,272 | 120,903 |
| Asset valuation reserve | 81,512 | 77,048 |
| Drafts outstanding | 31,624 | 26,236 |
| Funds held under coinsurance | 646,519 | 582,795 |
| Other liabilities | 318,581 | 293,133 |
| Separate account liabilities | 7,217,838 | 7,179,068 |
| TOTAL LIABILITIES | 16,447,356 | 15,470,990 |
| SURPLUS | | |
| Surplus notes | 389,412 | 389,231 |
| Unassigned surplus | 1,398,280 | 1,410,545 |
| TOTAL SURPLUS | 1,787,692 | 1,799,776 |
| TOTAL LIABILITIES AND SURPLUS | \$18,235,048 | \$17,270,766 |

The accompanying notes are an integral part of these financial statements.

(In Thousands)

Statements of Income and Changes in Surplus

| For the Years Ended December 31, | 2015 | 2014 |
|--|--------------------|--------------------|
| REVENUE | | |
| Premium and annuity considerations | \$1,196,285 | \$ 664,006 |
| Net investment income | 531,844 | 480,366 |
| Other revenue | 470,769 | 293,549 |
| TOTAL REVENUE | 2,198,898 | 1,437,921 |
| BENEFITS AND EXPENSES | | |
| Benefits paid to policyholders and beneficiaries | 1,068,093 | 1,049,517 |
| Increase/(Decrease) in reserves for payment of future insurance and annuity benefits | 375,014 | (311,032) |
| Commissions | 138,524 | 120,362 |
| Operating expenses | 294,228 | 252,881 |
| Other expenses | 106,666 | 103,581 |
| Net transfer to separate accounts | 110,916 | 151,215 |
| TOTAL BENEFITS AND EXPENSES | 2,093,441 | 1,366,524 |
| GAIN FROM OPERATIONS BEFORE DIVIDENDS AND FEDERAL INCOME TAX EXPENSE | 105,457 | 71,397 |
| Dividends to policyholders | 50,092 | 43,474 |
| GAIN FROM OPERATIONS BEFORE FEDERAL INCOME TAX EXPENSE | 55,365 | 27,923 |
| Federal income tax (benefit)/expense | (35,213) | 36,037 |
| GAIN/(LOSS) FROM OPERATIONS | 90,578 | (8,114) |
| Net realized capital gains, net of tax | 10,731 | 17,398 |
| NET INCOME | \$ 101,309 | \$ 9,284 |
| SURPLUS | | |
| Net income | \$ 101,309 | \$ 9,284 |
| Change due to reinsurance | 20,813 | 173,062 |
| Change in asset valuation reserve | (4,464) | (26,842) |
| Change in net unrealized capital gains, net of tax | (97,207) | 113,091 |
| Change in net deferred income tax | (5,797) | 63,648 |
| Change in funded status of postretirement plans | (1,841) | (16,559) |
| Change in surplus notes | 181 | 168 |
| Change in nonadmitted assets | (25,078) | (6,762) |
| Change in surplus | (12,084) | 309,090 |
| Surplus, beginning of year | 1,799,776 | 1,490,686 |
| Surplus, end of year | \$1,787,692 | \$1,799,776 |

The accompanying notes are an integral part of these financial statements.

(In Thousands)

Statements of Cash Flows

| For the Years Ended December 31, | 2015 | 2014 |
|--|-------------------|-------------------|
| OPERATIONS | | |
| Premium and annuity considerations | \$1,997,573 | \$1,530,568 |
| Net investment income | 513,611 | 415,884 |
| Other revenue | 264,627 | 200,362 |
| CASH PROVIDED BY OPERATIONS | 2,775,811 | 2,146,814 |
| Benefits paid | 1,020,568 | 1,035,067 |
| Commissions and operating expenses | 515,474 | 487,065 |
| Net transfers to separate accounts | 97,155 | 145,761 |
| Dividends to policyholders | 16,479 | 35,197 |
| Taxes refunded on operating income and realized investment losses | 81,324 | (10,187) |
| CASH USED IN OPERATIONS | 1,731,000 | 1,692,903 |
| NET CASH PROVIDED BY OPERATIONS | 1,044,811 | 453,911 |
| INVESTMENT ACTIVITIES | | |
| Investments sold, matured or repaid: | | |
| Bonds | 1,371,168 | 1,827,619 |
| Preferred and common stocks | 77,353 | 18,858 |
| Limited partnerships, real estate and other invested assets | 27,856 | 36,101 |
| Derivatives | 71,564 | 56,931 |
| NET PROCEEDS FROM INVESTMENTS SOLD, MATURED OR REPAID | 1,547,941 | 1,939,509 |
| Cost of investments acquired: | | |
| Bonds | 2,096,937 | 2,018,453 |
| Preferred and common stock | 126,644 | 134,606 |
| Limited partnerships, real estate and other invested assets | 123,898 | 112,205 |
| Derivatives | 56,186 | — |
| TOTAL COST OF INVESTMENTS ACQUIRED | 2,403,665 | 2,265,264 |
| Net (increase)/decrease in policy loans | (9,891) | 882 |
| NET CASH USED IN INVESTMENT ACTIVITIES | (865,615) | (324,873) |
| FINANCING AND MISCELLANEOUS | | |
| Net withdrawals on deposit-type contracts | (17,461) | (13,724) |
| Other cash applied/(used), net | (43,365) | (55,345) |
| NET CASH PROVIDED BY/(USED IN) FINANCING AND MISCELLANEOUS | (62,825) | (69,069) |
| NET INCREASE IN CASH AND SHORT-TERM INVESTMENTS | 116,371 | 59,969 |
| Cash and short-term investments: | | |
| Beginning of year | 128,700 | 68,731 |
| End of year | \$ 245,071 | \$ 128,700 |
| Supplemental Disclosure of Cash Flow Information for Non-Cash Transactions: | | |
| Common stock acquired in the form of a dividend | \$ 132,560 | |
| Premiums paid from benefits | 39,393 | |
| Premiums paid by dividend | 26,990 | |
| Premiums paid by policy loan | 5,743 | |
| Capitalized interest | 2,101 | |
| Other | 6,149 | |

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

Note 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

NATURE OF OPERATIONS The Penn Mutual Life Insurance Company (the “Company”) is a mutual life insurance company, domiciled in Pennsylvania, which concentrates primarily in the sale of individual life insurance and annuity products. The primary products that the Company currently markets are traditional whole life, one year non-renewable and level term, universal life, indexed universal life, variable universal life, immediate annuities and deferred annuities, both fixed and variable. The Company markets its products through a network of career agents, independent agents, and independent marketing organizations. The Company is licensed to write business in all fifty states and the District of Columbia.

BASIS OF PRESENTATION The accompanying financial statements of the Company have been prepared in conformity with the National Association of Insurance Commissioner’s (“NAIC”) Practices and Procedures manual and with statutory accounting practices prescribed or permitted by the Insurance Department of the Commonwealth of Pennsylvania (collectively “SAP” or “statutory accounting principles”). Prescribed statutory accounting practices include publications of the NAIC, state laws, regulations and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed. The Company currently has no permitted practices.

Statutory accounting principles are different in some respects from U.S. Generally Accepted Accounting Principles (“GAAP”). The more significant differences between statutory accounting principles and GAAP are as follows:

- (a) certain acquisition costs, such as commissions and other variable costs, that are directly related to the successful acquisition of new business, are charged to current operations as incurred, whereas GAAP generally capitalizes these expenses and amortizes them based on profit emergence over the expected life of the policies or over premium payment period;
- (b) statutory policy reserves are based upon the Commissioners’ Reserve Valuation Method (“CRVM”) or net level premium method and prescribed statutory mortality, morbidity and interest assumptions, whereas GAAP reserves would generally be based upon the net level premium method or the estimated gross margin method, with estimates of future mortality, morbidity and interest assumptions;
- (c) bonds are generally carried at amortized cost, whereas GAAP generally reports bonds at fair value;
- (d) undistributed earnings from alternative assets are included in unrealized gains and losses, whereas GAAP would treat these changes as net investment income;
- (e) deferred income taxes, which provide for book versus tax temporary differences, are subject to limitation and are charged to surplus, whereas GAAP would generally include the change in deferred taxes in net income;
- (f) payments received for universal and variable life insurance products and variable annuities are reported as premium income and changes in reserves, whereas GAAP would treat these payments as deposits to policyholders’ account balances;
- (g) assets are reported at “admitted asset” value and “nonadmitted assets” are excluded through a charge against surplus, whereas GAAP records these assets net of any valuation allowance;
- (h) majority-owned subsidiaries are accounted for using the equity method. The Penn Insurance and Annuity Company (“PIA”), Hornor Townsend & Kent, Inc. (“HTK”), and Independence Square Properties LLC (“ISP”) are admitted assets. Penn Mutual Asset Management, Inc. (“PMAM”), (formerly Independence Capital Management Inc.), is a nonadmitted asset, whereas GAAP would consolidate these entities;
- (i) surplus notes are reported in surplus, whereas GAAP would report these notes as debt. Costs associated with these notes are expensed, whereas GAAP capitalizes those expenses and amortizes them into income over the life of the notes;
- (j) reinsurance reserve credits are reported as a reduction of policyholders’ reserves and liabilities for deposit-type contracts, whereas GAAP would report these balances as an asset;
- (k) an asset valuation reserve (“AVR”) is reported as a contingency reserve to stabilize surplus against fluctuations in the carrying value of stocks, real estate investments, partnerships, limited liability companies (“LLCs”), low income housing tax credit (“LIHTC”) investments, and certain credit related derivative instruments as well as credit-related declines in the value of bonds, whereas GAAP does not record this reserve;

- (l) after-tax realized capital gains and losses which result from changes in the overall level of interest rates for all types of fixed-income investments and interest-related hedging activities are deferred into the interest maintenance reserve (“IMR”) and amortized into investment income over the remaining life of the investment sold, whereas GAAP reports these gains and losses as revenue at time of sale;
- (m) changes in the fair value of the derivative financial instruments are recorded as changes in surplus, unless deemed an effective hedge when it is carried at amortized cost with no resulting changes in fair value; changes in fair value for GAAP are reported as income for non-hedging transactions and effective fair value hedges; changes in fair value for GAAP are reported as other comprehensive income for effective cash flow hedges;
- (n) comprehensive income is not presented whereas GAAP presents changes in unrealized capital gains and losses, changes in funded status of pension and postretirement plans, and foreign currency translations as other comprehensive income;
- (o) embedded derivatives are recorded as part of the underlying contract, whereas GAAP would identify and bifurcate certain embedded derivatives from the underlying contract or security and account for them separately;
- (p) policyholder dividends are recognized when declared, whereas GAAP recognizes these over the term of the related policies;
- (q) company investment in the separate accounts in the form of seed money is presented as separate account assets, whereas GAAP presents the investment as a general account equity investment;
- (r) identification of other-than-temporary impairment uses an “intent and ability to hold” criteria whereas GAAP uses an “intent and ability not to sell” criteria; and
- (s) the investment in Federal Home Loan Bank stock is reported as an investment in common stock, unaffiliated, whereas for GAAP this is reported within other invested assets.

The Company’s net income as presented in its consolidated financial statements prepared in conformity with GAAP was \$208,620 and \$177,683 for the years ended December 31, 2015 and 2014, respectively. The Company’s equity as presented in its consolidated financial statements prepared in conformity with GAAP was \$2,977,877 and \$3,019,662 as of December 31, 2015 and 2014, respectively.

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

USE OF ESTIMATES The preparation of financial statements requires management to make estimates and assumptions that impact the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Those estimates are inherently subject to change and actual results could differ from those estimates. Included among the material reported amounts and disclosures that require extensive use of estimates are:

- ◇ Carrying value of certain invested assets and derivatives
- ◇ Liabilities for reserves and funds for payment of insurance and annuity benefits
- ◇ Accounting for income taxes and valuation of deferred income tax assets and liabilities and unrecognized tax benefits
- ◇ Litigation and other contingencies
- ◇ Pension and other postretirement and postemployment benefits

INVESTMENTS Bonds with a NAIC designation of 1 to 5 are valued at amortized cost. All other bonds are valued at the lower of cost or fair value. Fair value is determined using an external pricing service or management’s pricing models.

For fixed income securities that do not have a fixed schedule of payments, including asset-backed and mortgage-backed securities, the effect on amortization or accretion is revalued three times per year based on the current estimated cash flows, using the retrospective method, except for favorable changes in expected cash flows for structured securities where the possibility of non-interest loss is other than remote. In these cases, income is recognized on the prospective method over the remaining life of the securities. Under the retrospective method, the recalculated effective yield equates the present value of the actual and anticipated cash flows, including new prepayment assumptions, to the original cost of the investment. Prepayment assumptions are based on borrower

constraints and economic incentives such as original term, age, and coupon of the loan as affected by the interest rate environment. The current carrying value is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased. Cash flow assumptions for structured securities are obtained from broker dealer survey values or internal estimates. These assumptions are consistent with the current interest rate and economic environment.

Preferred Stock with a NAIC designation of 1 to 3 is valued at amortized cost. All other preferred stock is valued at the lower of cost or market. Fair value is determined using an external pricing service or management's pricing model.

Common Stock of the Company's insurance affiliates is carried at its underlying audited statutory equity. Common stock of audited non-insurance affiliates is admitted at the GAAP-basis equity. Common stock of unaudited non-insurance affiliates is nonadmitted. Unaffiliated common stock is carried at fair value. Dividends are recognized in net investment income on the ex-dividend date. Other changes in the carrying value of affiliates are recognized as changes in unrealized gains or losses in surplus. The investment in capital stock of the Federal Home Loan Bank of Pittsburgh ("FHLB-PGH") is carried at par, which approximates fair value. See the "Federal Home Loan Bank Borrowings" caption within this footnote for additional information on FHLB-PGH.

The non-interest portion is determined based on the Company's "best estimate" of future cash flows discounted to a present value using the appropriate yield. The difference between the present value of the best estimate of cash flows and the amortized cost is the non-interest loss. The remaining difference between the amortized cost and the fair value is the interest loss.

Real Estate occupied by the Company is carried at depreciated cost. Depreciated cost is adjusted for impairments whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable, with the impairment being included in realized capital losses. Depreciation is calculated using the straight-line method over the estimated useful life of the real estate holding, not to exceed 40 years. Depreciation expense is included in net investment income. The Company obtains an external appraisal on a tri-annual basis. The most recent appraisal was as of June 2013.

Policy Loans are carried at the aggregate balance of unpaid principal and interest.

Cash and Short-term investments Cash includes investments purchased with maturities of three months or less. Short-term investments, which are carried at amortized cost and approximate fair value, consist primarily of money market funds and investments purchased with maturities of greater than three months and less than or equal to 12 months.

Alternative Assets consist primarily of limited partnerships. The Company accounts for the value of its investments at their underlying GAAP equity. Dividends/income distributions from limited partnerships are recorded in investment income. Undistributed earnings are included in unrealized gains and losses and are reflected in surplus, net of deferred taxes. Distributions that are recorded as a return of capital reduce the carrying value of the limited partnership investment. Due to the timing of the valuation data received from the general partner, these investments are reported in accordance with the most recent valuations received which are primarily on a one quarter lag.

Other Invested Assets The Company utilizes derivative financial instruments, including interest rate swaps, inflation swaps, financial futures, currency forwards, interest rate caps and equity options, in the normal course of business to manage risk, in conjunction with its management of assets and liabilities and interest rate risk. The accounting treatment of specific derivatives depends whether on the financial instrument is designated and qualifies as a highly effective hedge. Derivatives used in hedging transactions that meet the criteria of a highly effective hedge are reported and valued in a manner that is consistent with the assets hedged. The change in fair value of these derivatives is recognized as an unrealized capital gain or (loss) until they are closed, at which time they are recorded in realized capital gains/ (losses). Derivatives used in risk management transactions that do not meet the criteria of an effective hedge are accounted for at fair value, with changes in fair value recorded in unrealized capital gains/ (losses). Derivatives with a positive fair value or carrying value are reported in Other invested assets. Derivatives with a negative fair value or carrying value are reported in Other liabilities. Realized gains and losses

that are recognized upon termination or maturity of the derivatives used in economic hedges of interest rate risk of the fixed income portfolio, regardless of accounting treatment, are transferred, net of taxes, to the IMR. All other realized gains and losses are recognized in net income upon maturity or termination of derivative contracts.

The Company has entered into interest rate and currency swaps, interest rate futures and equity options in the form of call spreads that qualify for hedge accounting. The currency swaps have been designated to qualify as cash flow hedges of cash flows associated with foreign denominated securities in the investment portfolio. The equity options in the form of call spreads have been designated to qualify as cash flow hedges of cash flows associated with indexed credits related to the annual return of the S&P 500 Index on Indexed Universal Life (“IUL”) and Variable Universal Life (“VUL”) policies. The interest rate swaps have been designated to qualify as fair value hedges of the impact of changing interest rates on bonds in the corporate bond portfolio.

The Company may enter into interest rate swaps, total return swaps, inflation swaps, financial futures and equity options to hedge risks associated with the offering of equity market based guarantees in the Company’s annuity and indexed universal life insurance product portfolio, which do not meet the criteria of an effective hedge.

The Company uses currency forwards to hedge the risk embedded in its foreign currency denominated alternative assets. They are carried at fair value and do not meet the criteria of an effective hedge.

Interest rate caps, credit default swaps and receiver swaps, a type of interest rate swap, are carried at fair value. The Company’s use of interest rate caps is designed to manage risk associated with rising interest rates. Credit default swaps protect the Company from a decline in credit quality of a specified security. Receiver swaps protect the Company from credit risk in the fixed income portfolio. These do not meet the criteria of an effective hedge.

Investment income is recorded on an accrual basis. Amounts payable or receivable under total return, currency, credit default interest rate and inflation swap agreements are recognized as investment income or expense when incurred. The Company does not engage in derivative financial instrument transactions for speculative purposes. Refer to Note 6 for additional disclosures regarding derivatives.

The Company invests in LIHTC investments, which generate tax credits for investing in affordable housing projects. Investments in LIHTC are included in other invested assets and are accounted for under the cost method. The delayed equity contributions for these investments are unconditional and legally binding and therefore, have been recognized as a liability. LIHTC investments are reviewed for Other than temporary impairment (“OTTI”), which is accounted for as a realized loss. See Note 3 for additional information regarding LIHTC investments.

Other invested assets also include notes receivable from Janney Montgomery Scott, LLC (“JMS”), an affiliate, and the Company’s investment in its affiliate, ISP. See Note 11 for additional information regarding these other invested assets.

OTTI EVALUATION The carrying values of bonds, mortgage-backed, asset-backed securities, alternative assets and LIHTCs are written down when a decline is considered to be other-than-temporary.

Bonds, mortgage-backed and asset-backed securities The Company considers an impairment to be other-than-temporary if: (a) the Company’s intent is to sell, (b) the Company will more likely than not be required to sell, (c) the Company does not have the intent and ability to hold the security for a period of time sufficient to recover the amortized cost basis, or (d) the Company does not expect to recover the entire amortized cost basis. The Company conducts a periodic management review of all bonds including those in default, not-in-good standing, or otherwise designated by management. The Company also considers other qualitative and quantitative factors in determining the existence of OTTI including, but not limited to, unrealized loss trend analysis and significant short-term changes in value, default rates, delinquency rates, percentage of nonperforming loans, prepayments, and severities. If the impairment is other-than-temporary, the non-interest loss portion of the impairment is recorded through realized losses and the interest related portion of the loss is disclosed in the notes to the financial statements.

Alternative assets The Company’s evaluation for OTTI includes consideration of the remaining life of the partnerships and the performance of the underlying assets when evaluating the facts and circumstances

(In Thousands)

surrounding the recovery of the cost of the partnership investments. Any such impairments are accounted for as a realized loss.

LIHTC OTTI for LIHTC investments is determined by comparing the book value of the investment with the present value of future tax benefits. The investment is written down if the book value is higher than the present value and the impairment is accounted for as a realized loss.

INVESTMENT INCOME DUE AND ACCRUED Investment income due and accrued consists primarily of interest and dividends. Interest is recognized on an accrual basis and dividends are recorded as earned on the ex-dividend date. Due and accrued income is not recorded on: (a) bonds in default; (b) bonds delinquent more than 90 days or where collection of interest is improbable; and (c) policy loan interest due and accrued in excess of the cash surrender value of the underlying contract.

PREMIUMS DUE AND DEFERRED Deferred premium is the portion of premium not earned at the reporting date, net of loading. Loading is an amount obtained by subtracting the net premium from the gross premium and generally includes allowances for acquisition costs and other expenses. Deferred premium adjusts for the overstatement created in the calculation of reserves as the reserve computation assumes the entire year's net premium is collected annually at the beginning of the policy year and does not take into account installment or modal payments.

Uncollected premium is gross premium that is due and unpaid as of the reporting date, net of loading. Net premium is the amount used in the calculation of reserves. The change in loading is included as an expense and is not shown as a reduction to premium income. The deferred and uncollected amounts and loading were as follows at December 31:

| | 2015 | | | | 2014 | | | |
|---|---------|----------|-------|----------|---------|----------|-------|----------|
| | New | Renewal | Group | Total | New | Renewal | Group | Total |
| Uncollected premium | \$ 126 | \$ 8,570 | NA | | \$ 233 | \$ 7,771 | NA | |
| Uncollected loading | (98) | (1,117) | NA | | (194) | (622) | NA | |
| Net uncollected | 28 | 7,453 | \$420 | \$ 7,901 | 39 | 7,149 | \$385 | \$ 7,573 |
| Deferred premium | 10,979 | 51,853 | NA | | 9,890 | 46,999 | NA | |
| Deferred loading | (8,499) | 8,678 | NA | | (7,631) | 7,862 | NA | |
| Net deferred | 2,480 | 60,531 | 7 | 63,018 | 2,259 | 54,861 | 8 | 57,128 |
| Subtotal — gross deferred and uncollected | | | | 70,919 | | | | 64,701 |
| Nonadmitted | | | | (1,123) | | | | (1,150) |
| Premiums due and deferred, net | | | | \$69,796 | | | | \$63,551 |

FEDERAL INCOME TAX The Company files a consolidated federal income tax return with its insurance and non-insurance subsidiaries. Each subsidiary's tax liability or refund is accrued on a benefits for loss basis. The Company reimburses subsidiaries for losses utilized in the consolidated return based on inter-company tax allocation agreements. The provision for federal income taxes is computed in accordance with the section of the Internal Revenue Code applicable to life insurance companies and is based on income that is currently taxable.

Uncertain tax positions ("UTP") are established when the merits of a tax position are evaluated against certain measurement and recognition tests. UTP changes are reflected as a component of income taxes.

Deferred income tax assets and liabilities are established to reflect the impact of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. These deferred tax assets or liabilities are measured by using the enacted tax rates expected to apply to taxable income in the period in which the deferred tax liabilities or assets are expected to be settled or realized. Changes in the deferred tax balances are reported as adjustments to surplus. Deferred tax assets, after the consideration of any necessary valuation allowance, in excess of the statutory limits are treated as nonadmitted assets and charged to surplus.

CORPORATE OWNED LIFE INSURANCE The Company purchases life insurance policies on certain officers and employees on which the Company is designated as the beneficiary. The Company recognizes the cash surrender value of the policies as an asset on the Statement of Admitted Assets, Liabilities and Surplus. Changes in the cash surrender value of the policies are recorded as an adjustment to the premiums paid for the insurance coverage, which is recognized as part of interest credited to policyholders within Benefit paid to policyholders and beneficiaries on the Statements of Income.

REINSURANCE In the normal course of business, the Company seeks to limit its exposure to loss on any single insured and to recover a portion of benefits paid by ceding reinsurance to other insurance enterprises or reinsurers under excess coverage and coinsurance contracts. The Company has set its retention limit for acceptance of risk on life insurance policies at various levels up to \$5,000 for single life and \$7,500 for joint lives.

Reinsurance does not relieve the Company of its primary liability and, as such, failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the risk transfer of its reinsurance contracts and the financial strength of potential reinsurers. The Company regularly monitors the financial condition and ratings of its existing reinsurers to ensure that amounts due from reinsurers are collectible.

Insurance liabilities are reported net of the effects of reinsurance. Estimated reinsurance recoverables are recognized in a manner consistent with the liabilities related to the underlying reinsured contracts. See Note 10 for further discussion.

Funds Held Under Coinsurance The Company records a liability for funds held pursuant to a 70% coinsurance with funds withheld agreement entered into with PIA. The liability represents the economic reserves under the terms of the reinsurance agreement. Refer to Note 8 for further discussion of this reinsurance agreement.

OTHER ASSETS Computer equipment and packaged software is reported at cost of \$100,608 and \$97,032 less accumulated depreciation of \$81,467 and \$79,168 at December 31, 2015 and 2014, respectively. Computer equipment and packaged software is depreciated using the straight-line method over the lesser of its useful life or three years. Depreciation expense on computer equipment and packaged software charged to operations in 2015 and 2014 was \$2,299 and \$1,825, respectively. Furniture is depreciated on a straight-line basis over the estimated useful lives of the related assets. Leasehold improvements are depreciated over the remaining life of the lease. Building and property improvements are depreciated to the lesser of contractor estimate or the remaining life of the building.

In 2013, the Company entered into agreements to sell, and subsequently leaseback, certain assets. These agreements are considered operating leases. See Note 12 for additional discussion of these leaseback commitments.

Other assets also includes receivables related to centrally cleared derivative transactions, receivables for collateral remitted to counterparties, amounts due from affiliates under the terms of service agreements. See Note 6 for additional information regarding derivative transactions and Note 11 for additional information regarding related party transactions.

SEPARATE ACCOUNT ASSETS AND LIABILITIES The Company has separate account assets and liabilities representing segregated funds administered and invested by the Company primarily for the benefit of variable life insurance policyholders and annuity and pension contractholders, including the Company's benefit plans. The assets of each account are legally segregated and are generally not subject to claims that arise out of any other business of the Company. The Separate accounts have varying investment objectives.

Separate account assets are stated at the fair value of the underlying assets, which are shares of mutual funds. The value of the assets in the Separate accounts reflects the actual investment performance of the respective accounts and is not guaranteed by the Company. The liability represents the policyholders' interest in the account and includes accumulated net investment income and realized and unrealized capital gains/ (losses) on the assets, which reflects fair value. The investment income and realized capital gains/(losses) from separate account assets accrue to the policyholders and are not included in the Statements of Income. Mortality, policy administration, surrender charges assessed and asset management fees charged against the accounts are included in other revenue in the accompanying Statements of Income.

The Company issues variable annuity contracts in the separate accounts in which the Company provides various forms of guarantees to benefit the related contract holders called Guaranteed Minimum Death Benefits (“GMDB”), Guaranteed Minimum Accumulated Benefits (“GMAB”), GMAB/Guaranteed Minimum Withdrawal Benefits (“GMWB”) and GMWB with inflation protection. In accordance with guarantees provided, if the investment proceeds in the separate accounts are insufficient to cover the guarantees for the product, the policyholder proceeds will be remitted by the general account. See Note 4 for a discussion of the Company’s obligation regarding these product features.

NONADMITTED ASSETS Assets designated as nonadmitted by the NAIC include furniture, certain electronic data processing equipment, unamortized software, the amount of the deferred tax asset that is in excess of limits prescribed by SAP, the pension plan assets, certain investments in partnerships for which financial audits are not performed, certain other receivables, advances and prepayments, and uncollected premiums greater than 90 days from the due date. Such amounts are excluded from the Statements of Admitted Assets, Liabilities and Surplus. As of December 31, 2015 and 2014, the Company’s total nonadmitted assets were \$184,986 and \$159,908, respectively.

RESERVES AND FUNDS FOR THE PAYMENT OF INSURANCE AND ANNUITY BENEFITS Policyholders’ reserves provide amounts adequate to discharge estimated future obligations in excess of estimated future premium on policies in-force. Any adjustments that are made to the reserve balances are reflected in the Statements of Income in the year in which such adjustments are made, with the exception of changes in valuation bases which are accounted for as charges or credits to surplus.

Reserves and funds for the payment of future life and annuity benefits are developed using actuarial methods based on statutory mortality and interest requirements. Reserves for life insurance contracts are developed using accepted actuarial methods computed principally on the net level, modified preliminary term or CRVM methods using the 1941, 1958, 1980, and 2001 Commissioners’ Standard Ordinary Mortality and American Experience Tables and assumed interest rates ranging from 2.25% to 4.50%. Reserves for substandard policies are computed using multiples of the respective underlying mortality tables. The Company has universal life contracts with secondary guarantee features. The Company establishes reserves according to Actuarial Guideline XXXVIII.

The Company waives deduction of deferred fractional premium at death and returns any portion of the final premium beyond the date of death. Reserves are computed using continuous functions to reflect these practices. Surrender values are not promised in excess of the legally computed reserves.

Reserves for deferred fixed individual annuity contracts are developed using accepted actuarial methods computed principally under the Commissioners’ Annuity Reserve Valuation Method using applicable interest rates and mortality tables, primarily on the 1949, 1971, 1983 and 2000 Individual Annuity Mortality Tables and rates ranging from 2.00% to 13.25%.

The Company also has deferred variable annuity contracts containing GMDB, GMAB and GMWB features. The Company establishes reserves according to requirements prescribed by the NAIC in Actuarial Guideline XLIII (VACARVM). See Note 4 for further discussion.

Reserves for group annuity contracts are developed using accepted actuarial methods computed principally on the 1971 and 1983 Group Annuity Mortality Tables and 1994 Group Annuity Reserving Tables with assumed interest rates ranging from 4.50% to 13.25%.

The Company had \$5,665,313 and \$6,407,597 and as of December 31, 2015 and 2014, respectively, of insurance in force for which the gross premiums are less than the net premiums according to the standards of valuation set by the Commonwealth of Pennsylvania.

The tabular interest has been determined from the basic data for the calculation of policy reserves. The tabular less actual reserves released have been determined by formula.

LIABILITIES FOR DEPOSIT-TYPE CONTRACTS Reserves for funding agreements, dividend accumulations, premium deposit funds, investment-type contracts such as supplementary contracts not involving life contingencies, and certain structured settlement annuities are based on account value or accepted actuarial methods using applicable interest rates.

The tabular interest for funds not involving life contingencies is determined as the change in reserves less funds added during the year less other increases, plus funds withdrawn during the year-end.

POLICYHOLDER' DIVIDENDS The liability for policyholders' dividends includes the estimated amount of annual dividends and settlement dividends to be paid to policyholders in the following year. Policyholders' dividends incurred are recorded in the Statements of Income. Dividends expected to be paid to policyholders in the following year are approved annually by the Company's Board of Trustees. The allocation of these dividends to policyholders reflects the relative contribution of each group of participating policies to surplus and considers, among other factors, investment returns, mortality and morbidity experience, expenses, and income tax charges.

POLICY CLAIMS IN PROCESS include provisions for payments to be made on reported claims and claims incurred but not reported.

INTEREST MAINTENANCE RESERVE The IMR captures the realized capital gains/ (losses) that result from changes in the overall level of interest rates and amortizes them into income over the calendar years to expected maturity.

ASSET VALUATION RESERVE AVR is a contingency reserve to stabilize surplus against fluctuations in the statement value of common stocks, real estate investments, partnerships, LIHTC investments, and LLCs as well as non-interest related declines in the value of bonds, and certain derivatives. The AVR is reported in the Statements of Admitted Assets, Liabilities and Surplus and the change in AVR is reported in the Statements of Changes in Surplus.

DRAFTS OUTSTANDING that have not been presented for payment are recorded as a liability.

OTHER LIABILITIES Other liabilities primarily include accruals for general and operating expense, the fair value of certain derivative contracts in a loss position, collateral received from counterparties related to certain derivative contracts (see Note 6 for additional discussion of derivatives), life insurance premiums received in advance of the due date, net transfers due from the separate accounts, and liabilities related to postretirement benefit plans in an underfunded position. See Note 8 for additional disclosures on the Company's benefit plans.

BENEFIT PLANS The Company recognizes a liability for the funded status of defined benefit pension and post retirement plans where the projected benefit obligation exceeds plan assets (underfunded) and nonadmits assets for the funded status of defined benefit pension and post retirement plans where the fair value of plan assets exceed the projected benefit obligation (overfunded). See Note 8 for additional disclosures on the Company's benefit plans.

CONTINGENCIES Amounts related to contingencies are accrued if it is probable that a liability has been incurred and an amount is reasonably estimable. Regarding litigation, management evaluates whether there are incremental legal or other costs directly associated with the ultimate resolution of the matter that are reasonably estimable and, if so, includes these costs in the accrual. See Note 12 for further discussion.

SURPLUS NOTES On July 1, 2010, the Company issued Surplus Notes ("2010 Notes") with a principal balance of \$200,000, at a discount of \$8,440. The 2010 Notes bear interest at 7.625%, and have a maturity date of June 15, 2040. The 2010 Notes were issued pursuant to Rule 144A under the Securities Act of 1933, as amended and are administered by a U.S. bank as registrar/paying agent. Interest on the 7.625% 2010 Notes is scheduled to be paid semiannually on March 31 and September 30 of each year. At December 31, 2015 and 2014, the amortized cost basis of the 2010 Notes was \$192,065 and \$191,956, respectively. Interest paid on the 2010 Notes was \$15,250 and \$15,250 for the years ended December 31, 2015 and 2014, respectively. Total interest paid since the issuance of the 2010 Notes is \$80,063.

On June 23, 2004, the Company issued Surplus Notes ("2004 Notes") with a principal balance of \$200,000, at a discount of \$3,260. The 2004 Notes bear interest at 6.65%, and have a maturity date of June 15, 2034. The 2004 Notes were issued pursuant to Rule 144A under the Securities Act of 1933, as amended and are administered by a U.S. bank as registrar/paying agent. Interest on the 6.65% 2004 Notes is scheduled to be paid semiannually on April 1 and October 1 of each year. At December 31, 2015 and 2014, the amortized cost basis of the 2004 Notes was \$197,347 and \$197,275, respectively. Interest paid on the 2004 Notes was \$13,300 and \$13,300 for the years ended December 31, 2015 and 2014, respectively. Total interest paid since the issuance of the 2004 Notes is \$149,920.

Interest expense on surplus notes requires prior approval from the Pennsylvania Insurance Department.

RISK-BASED CAPITAL Life insurance companies are subject to certain risk-based capital (RBC) requirements as specified by the NAIC. Under those requirements, minimum amounts of statutory surplus are required to be maintained based on various risk factors related to it. At December 31, 2015, the Company's surplus exceeds these minimum levels.

PREMIUM AND RELATED EXPENSE RECOGNITION Life insurance premium revenue is generally recognized as revenue on the gross basis when due from the policyholders under the terms of the insurance contract. Annuity premium on policies with life contingencies is recognized as revenue when received. Both premium and annuity considerations are recorded net of reinsurance premiums. Commissions and other costs related to issuance of new policies, and policy maintenance and settlement costs are charged to current operations when incurred. Surrender fee charges on certain life and annuity products are recorded as a reduction of benefits. Benefit payments are reported net of the amounts received from reinsurers.

The Company accounts for deposit-type contracts (those that do not subject the Company to mortality or morbidity risk) under the deposit method. Amounts received from and payments to policyholders related to these contracts are recorded directly against the related policy reserves. Interest credited to policyholder accounts is reflected in benefits paid to policyholders and beneficiaries. Fees charged to policyholder accounts are reflected in Other revenue.

OTHER REVENUE Other revenue includes commission and expense allowance recognized by the Company pursuant to reinsurance agreements, as well as the modified coinsurance reserve adjustment relating to a coinsurance/modified coinsurance reinsurance agreement entered into with a third party effective December 31, 2015. Other revenue also includes fees charged to policyholders.

OTHER EXPENSES Other expenses includes amounts paid to PIA relating to interest earned on the funds withheld assets held by the Company pursuant to the 70% coinsurance with funds withheld agreement entered into with PIA that is discussed in Note 10. Other expenses also includes benefits paid by the Company under reinsurance agreements with PIA relating to index credits on certain universal life policies.

REALIZED AND UNREALIZED CAPITAL GAINS AND LOSSES Realized capital gains and losses, net of taxes, excludes gains and losses transferred to the IMR. Realized capital gains and losses are recognized in net income and are determined using the specific identification method.

All after-tax realized capital gains and losses which result from changes in the overall level of interest rates for all types of fixed-income investments and interest-related derivative activities for derivatives backing assets are transferred to the IMR and amortized into revenue. These interest-related gains and losses are amortized into net investment income using the grouped method over the remaining life of the investment sold or, in the case of derivative financial instruments, over the remaining life of the underlying asset.

Unrealized capital gains and losses, net of deferred federal income taxes, are recorded as a change in surplus.

FEDERAL HOME LOAN BANK BORROWINGS In August 2014, the Company became a member of the FHLB-PGH, which provides access to collateralized advances, collateralized funding agreements, and other FHLB-PGH products. Collateralized advances from the FHLB-PGH are classified in "Borrowed money." Collateralized funding agreements issued to the FHLB-PGH are classified as liabilities for deposit-type funds and are recorded within "Reserves and funds for payment of insurance and annuity benefits." FHLB-PGH is a first-priority secured creditor.

The Company's membership in FHLB-PGH requires the ownership of member stock, and borrowings from FHLB-PGH require the purchase of FHLB-PGH activity based stock in an amount equal to 4% of the outstanding borrowings. All FHLB-PGH stock purchased by the Company is classified as restricted general account investments within "Common stock—unaffiliated." The Company's borrowing capacity is determined by the lesser of the assets available to be pledged as collateral to FHLB-PGH or 10% of the Company's prior period admitted general account assets. The fair value of the qualifying assets pledged as collateral by the Company must be maintained at certain specified levels of the borrowed amount, which can vary, depending on the nature of the assets pledged. The Company's agreement allows for the substitution of assets and the advances are pre-payable. Current borrowings are subject to prepayment penalties.

(In Thousands)

As of December 31, 2015 and 2014, borrowings from the FHLB-PGH, segregated by those classified as advances and funding agreements, including the maximum outstanding during the years ended December 31 were as follows:

| | 2015 | Maximum during 2015 | 2014 | Maximum during 2014 |
|--------------------|-----------|------------------------|------|------------------------|
| Debt — Advances | \$ — | \$ — | \$— | \$ — |
| Funding Agreements | 450,000 | 450,000 | — | 100,000 |
| Total | \$450,000 | \$450,000 | \$— | \$100,000 |

NEW ACCOUNTING STANDARDS

During 2015 the NAIC adopted revisions to SSAP No. 69, “Statement of Cash Flow (SSAP No. 69),” which clarified that the Statutory Statement of Cash Flow shall include only those transactions involving cash. These revisions are effective for the year ended December 31, 2015 and have been reflected in the Company’s Statement of Cash Flows.

During 2015, the NAIC adopted revisions to SSAP No. 93, “Accounting for LIHTC Property Investments (SSAP No. 93),” which became effective for the year ended December 31, 2015. These revisions clarify the statutory accounting treatment for LIHTC investments in light of recent U.S. GAAP guidance impacting LIHTC’s. For statutory accounting purposes, LIHTC investments continue to be amortized utilizing a proportional amortized cost method and the inclusion of federal tax benefits received during the holding period. Additionally, the revisions added certain disclosure regarding the amount of low-income housing tax credits and other tax benefits recognized during the years presented, and the balance of the investment recognized in the statement of financial position for the reporting periods presented. The Company has adopted the disclosure requirements, which are included in Note 3 and Note 9.

During 2015, the NAIC adopted revisions to SSAP No. 97, “Investments in Subsidiary, Controlled and Affiliated Entities” (“SCA”). These revisions include new requirement for reporting entities to disclose the gross, nonadmitted, and net admitted values of non-insurance SCAs, as well as certain information regarding the filing of such SCAs with the NAIC Securities Valuation Office. The additional disclosure requirements became effective for the year ended December 31, 2015. The Company has adopted the disclosure requirements, which are included in Note 11.

Note 3. INVESTMENTS

The Company maintains a diversified investment portfolio. Investment policies limit concentration in any asset class (except for U.S. Treasury and U.S. Government guaranteed securities), geographic region, industry group, economic characteristic, investment quality, or individual investment.

BONDS AND PREFERRED STOCK The following summarizes the admitted value and estimated fair value of the Company’s investment in bonds and preferred stock as of December 31:

| 2015 | Admitted Value | Gross Unrealized Capital | | Estimated Fair Value |
|--|--------------------|-----------------------------|------------------|-------------------------|
| | | Gains | Losses | |
| U.S. Treasury, U.S. Agency and other governmental securities | \$ 267,478 | \$ 6,891 | \$ 7,585 | \$ 266,784 |
| States and political subdivisions | 1,116,530 | 129,477 | 7,489 | 1,238,518 |
| Corporate securities | 4,019,897 | 270,799 | 132,668 | 4,158,028 |
| Residential mortgage-backed securities | 210,292 | 15,549 | 1,002 | 224,839 |
| Commercial mortgage-backed securities | 1,480,434 | 40,462 | 20,520 | 1,500,376 |
| Asset-backed securities | 1,040,326 | 22,600 | 25,205 | 1,037,721 |
| Total bonds | 8,134,957 | 485,778 | 194,469 | 8,426,266 |
| Redeemable preferred stock | 72,595 | 4,456 | 53 | 76,998 |
| TOTAL BONDS AND PREFERRED STOCK | \$8,207,552 | \$490,234 | \$194,522 | \$8,503,264 |

(In Thousands)

| 2014 | Admitted Value | Gross Unrealized Capital | | Estimated Fair Value |
|--|--------------------|-----------------------------|-----------------|-------------------------|
| | | Gains | Losses | |
| U.S. Treasury, U.S. Agency and other governmental securities | \$ 408,464 | \$ 9,143 | \$ 2,816 | \$ 414,791 |
| States and political subdivisions | 968,415 | 176,569 | 887 | 1,144,097 |
| Corporate securities | 3,807,116 | 471,248 | 18,752 | 4,259,612 |
| Residential mortgage-backed securities | 161,249 | 20,290 | 117 | 181,422 |
| Commercial mortgage-backed securities | 1,404,702 | 89,916 | 2,971 | 1,491,647 |
| Asset-backed securities | 778,542 | 39,679 | 7,376 | 810,845 |
| Total bonds | 7,528,488 | 806,845 | 32,919 | 8,302,414 |
| Redeemable preferred stock | 72,905 | 3,376 | 248 | 76,033 |
| TOTAL BONDS AND PREFERRED STOCK | \$7,601,393 | \$810,221 | \$33,167 | \$8,378,447 |

Included in the table above are securities held in custody and restricted for use under a reinsurance agreement with an admitted value and fair value totaling \$632,040 and \$693,765, respectively, as of December 31, 2015 and \$574,172 and \$682,537, respectively as of December 31, 2014.

The following table summarizes the admitted value and estimated fair value of debt securities as of December 31, 2015 by contractual maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties. Securities that are not due on a single maturity are included as of the final maturity.

| | Admitted Value | Estimated Fair Value |
|---|--------------------|-------------------------|
| Due in one year or less | \$ 98,385 | \$ 99,859 |
| Due after one year through five years | 550,503 | 591,093 |
| Due after five years through ten years | 1,072,131 | 1,056,697 |
| Due after ten years | 3,504,650 | 3,739,087 |
| Residential mortgage-backed securities ⁽¹⁾ | 273,181 | 283,028 |
| Commercial mortgage-backed securities ⁽¹⁾ | 1,527,514 | 1,548,465 |
| Asset-backed securities ⁽¹⁾ | 1,108,593 | 1,108,037 |
| Total bonds | 8,134,957 | 8,426,266 |
| Redeemable preferred stock | 72,595 | 76,998 |
| TOTAL BONDS AND PREFERRED STOCK | \$8,207,552 | \$8,503,264 |

(1) Includes U.S. Treasury/Agency structured securities

Mortgage and other asset-backed securities consist of commercial and residential mortgage pass-through holdings, securities backed by home equity and manufactured housing loans, credit tenant leases and equipment trust certificates. These securities follow a structured principal repayment schedule and are rated investment grade, other than \$67,210, primarily in asset-backed securities. The mortgage and other asset-backed securities portfolios are presented separately in the maturity schedule due to the potential for prepayment. The weighted average life of this portfolio is 5.70 years.

Investments on deposit with regulatory authorities as required by law were \$3,859 and \$3,808 at December 31, 2015 and 2014, respectively. Investments pledged as collateral for derivative contracts were \$17,752 and \$3,821 at December 31, 2015 and 2014, respectively. These investments are not available for use by the Company. The Company also has pledged collateral in the form of cash for certain derivative transactions. Refer to Note 6 for additional disclosures on derivatives and related collateral.

(In Thousands)

At December 31, 2015, the largest industry concentration of the Company's portfolio was investments in the electric utilities sector of \$614,847, representing 7.5% of the total debt securities portfolio.

CREDIT LOSS ROLLFORWARD

The following represents a rollforward of the cumulative credit loss component of OTTI loss recognized in earnings on fixed maturity securities still held for which a portion of the OTTI loss was not recognized in earnings.:

| As of December 31, | 2015 | 2014 |
|--|-----------------|-----------------|
| Balance, beginning of period | \$30,731 | \$30,762 |
| Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period | — | (31) |
| Credit loss impairments previously recognized on securities impaired to fair value during the period | — | — |
| Credit loss impairment recognized in the current period on securities not previously impaired | — | — |
| Additional credit loss impairments recognized in the current period on securities previously impaired | — | — |
| Balance, end of period | \$30,731 | \$30,731 |

UNREALIZED LOSSES ON INVESTMENTS

Management has determined that the unrealized losses on the Company's investments in equity and fixed maturity securities at December 31, 2015 are temporary in nature.

The following tables are an analysis of the fair values and gross unrealized losses aggregated by bond category and length of time that the securities were in a continuous unrealized loss position as of December 31:

| 2015 | Less than 12 months | | Greater than 12 months | | Total | |
|--|---------------------|-------------------------------|------------------------|-------------------------------|--------------------|-------------------------------|
| | Fair Value | Gross Unrealized Capital Loss | Fair Value | Gross Unrealized Capital Loss | Fair Value | Gross Unrealized Capital Loss |
| U.S. Treasury, U.S. Agency and other governmental securities | \$ 149,978 | \$ 7,585 | \$ 5 | \$ — | \$ 149,983 | \$ 7,585 |
| States and political subdivisions | 201,214 | 6,743 | 12,789 | 746 | 214,003 | 7,489 |
| Corporate securities | 1,446,874 | 109,186 | 81,069 | 23,482 | 1,527,943 | 132,668 |
| Residential mortgage-backed securities | 70,638 | 1,002 | — | — | 70,638 | 1,002 |
| Commercial mortgage-backed securities | 484,300 | 18,287 | 28,687 | 2,233 | 512,987 | 20,520 |
| Asset-backed securities | 559,261 | 18,250 | 68,775 | 6,955 | 628,036 | 25,205 |
| Total Bonds | 2,912,265 | 161,053 | 191,325 | 33,416 | 3,103,590 | 194,469 |
| Redeemable Preferred Stock | 4,072 | 32 | 1,180 | 21 | 5,252 | 53 |
| TOTAL BONDS AND PREFERRED STOCK | \$2,916,337 | \$161,085 | \$192,505 | \$33,437 | \$3,108,842 | \$194,522 |

(In Thousands)

| | Less than 12 months | | Greater than 12 months | | Total | |
|--|---------------------|-------------------------------|------------------------|-------------------------------|--------------------|-------------------------------|
| | Fair Value | Gross Unrealized Capital Loss | Fair Value | Gross Unrealized Capital Loss | Fair Value | Gross Unrealized Capital Loss |
| 2014 | | | | | | |
| U.S. Treasury, U.S. Agency and other governmental securities | \$101,231 | \$ 1,797 | \$ 46,651 | \$ 1,019 | \$ 147,882 | \$ 2,816 |
| States and political subdivisions | 16,642 | 322 | 8,305 | 565 | 24,947 | 887 |
| Corporate securities | 375,393 | 10,582 | 182,082 | 8,170 | 557,475 | 18,752 |
| Residential mortgage-backed securities | 4,883 | 117 | — | — | 4,883 | 117 |
| Commercial mortgage-backed securities | 142,483 | 2,898 | 14,943 | 73 | 157,426 | 2,971 |
| Asset-backed securities | 248,320 | 4,501 | 30,583 | 2,875 | 278,903 | 7,376 |
| Total Bonds | 888,952 | 20,217 | 282,564 | 12,702 | 1,171,516 | 32,919 |
| Redeemable Preferred Stock | 21,437 | 236 | 788 | 12 | 22,225 | 248 |
| TOTAL BONDS AND PREFERRED STOCK | \$910,389 | \$20,453 | \$283,352 | \$12,714 | \$1,193,741 | \$33,167 |

Included in the December 31, 2015 amounts above is the interest portion of other-than-temporary impairments on securities of \$159.

Unrealized losses on debt securities that were in an unrealized loss position less than twelve months at December 31, 2015, totaled 83% of the Company's total fixed maturities unrealized loss, and unrealized losses on securities in an unrealized loss position greater than twelve months totaled 17% of the Company's total fixed maturities unrealized loss. Of the total amount of debt securities unrealized losses, \$172,900 or 89% is related to unrealized losses on investment grade securities. Investment grade is defined as a security having a credit rating in accordance with the NAIC methodology of 1 or 2. Unrealized losses on fixed maturity securities with a rating below investment grade represent \$21,623 or 11% of the Company's total fixed maturities unrealized losses.

The net increase in the number of securities with fair values below amortized cost and in the amount of unrealized capital losses is primarily related to the increasing interest rate environment; the 10yr and 30yr treasury rates rose 10 basis points and 27 basis points, respectively. Additionally, credit spreads widened across all major asset classes.

U.S. Treasury, U.S. Agency and Other Governmental Securities Unrealized losses on the Company's investments in U.S. Treasury, U.S. Agency and other governmental obligations were \$7,585 or 4% of the Company's unrealized losses for debt securities. These were spread over 19 securities primarily related to the increasing interest rate environment.

States and Political Subdivisions Unrealized losses on the Company's investments in states and political subdivisions were \$7,489 or 4% of the Company's unrealized losses for debt securities. These were spread over 60 securities and the increase in value is attributable to an increase in treasury rates since purchase and widening credit spreads for select names.

Corporate Securities Unrealized losses on corporate securities, which were primarily attributable to widening credit spreads and increasing interest rates since the date of purchase, were \$132,668 or 68% of the total unrealized losses for debt securities. The amount of unrealized losses on the Company's investment in corporate securities is spread over 423 individual securities with varying interest rates and maturities. There were 41 corporate securities with a fair value below 80% of the security's amortized cost. The decline in fair value is primarily attributable to the increase in interest rates plus widening of credit spreads among investment grade and high yield.

Residential and Commercial Mortgage-Backed Securities Unrealized losses on mortgage-backed securities were \$21,522 or 11% of the total unrealized losses for debt securities. The amount of unrealized capital losses on the

(In Thousands)

Company's investment in mortgage-backed securities was due to several factors, depending upon the security. In general, the causes were: the increase in Treasury rates, and spread widening specific to some individual securities. These losses were spread across 107 fixed and variable rate securities, 100% of which are investment grade. There were no mortgage-backed securities that were priced below 80% of the security's amortized cost. Management believes the collateral is sufficient to recover amortized cost. The Company measures its mortgage-backed portfolio for impairments based on the security's credit rating and whether the security has an unrealized loss. When the fair value of the security is below amortized cost and there are negative changes in estimated future cash flows, the security is deemed other than temporarily impaired. The Company also evaluates these securities for other than temporary impairments based on facts and circumstances, even if there has been no negative change in estimated future cash flows.

Asset-Backed Securities Unrealized losses on asset-backed securities were \$25,205 or 13% of the total unrealized losses for debt securities. The unrealized losses on these investments are primarily related to the increase in short-term interest rates and widening spreads for select issues. These losses are spread across 113 securities. Similar to mortgage-backed securities, the Company measures its asset-backed portfolio for impairments based on the security's credit rating and whether the security has an unrealized loss. When the fair value of a security is below amortized cost and there are negative changes in estimated future cash flows, the security is deemed other-than-temporarily impaired. The Company also evaluates these securities for other-than-temporary impairments based on facts and circumstances, even if there has been no negative change in estimated future cash flows. There were 3 asset-backed securities that were priced below 80% of the security's amortized cost.

Redeemable Preferred Stock Unrealized capital losses on redeemable preferred stock were \$53 or 0% of the total unrealized capital losses for debt securities. The amount of unrealized capital losses on the Company's investment in redeemable preferred stock is spread over 20 individual securities. There were no redeemable preferred stocks that were priced below 80% of the security's amortized cost.

COMMON STOCK – UNAFFILIATED Unaffiliated equity securities had gross unrealized capital gains of \$0 and \$127 and gross unrealized capital losses of \$23,365 and \$3,359 as of December 31, 2015 and 2014, respectively.

The following presents the gross unrealized capital losses and fair values for unaffiliated common stock with unrealized capital losses that are deemed to be only temporarily impaired and length of time that individual securities have been in an unrealized capital loss position, at:

| | Less than 12 months | | Greater than 12 Months | | | Total |
|--|---------------------|--|------------------------|--|------------|--|
| | | Gross Unrealized Capital Losses | | Gross Unrealized Capital Losses | | Gross Unrealized Capital Losses |
| | Fair Value | | Fair Value | | Fair Value | |
| Common stock — unaffiliated — December 31, 2015 | \$25,317 | \$6,834 | \$50,207 | \$16,531 | \$75,524 | \$23,365 |
| Common stock — unaffiliated — December 31, 2014 | 57,253 | 2,863 | 1,470 | 496 | 58,723 | 3,359 |

The amount of unrealized capital losses on the Company's investment in unaffiliated common stock is spread over 16 individual securities. There were 8 unaffiliated common stock securities that were priced below 80% of the security's cost. Management has determined that the unrealized losses on the Company's investments in unaffiliated common stock at December 31, 2015 are temporary in nature. For further discussion on how the Company evaluates the impairment, see Note 2.

Federal Home Loan Bank The Company's investment in the FHLB-PGH Class B Membership Capital Stock as of December 31, 2015 and 2014 was \$1,513 and \$1,621, respectively. The Company also invested \$18,000 and \$0 in FHLB-PGH Activity Stock as of December 31, 2015 and 2014. The Class B Membership Capital Stock held by the Company is subject to written notices of requests for redemption followed by a five year waiting period.

As of December 31, 2015 and 2014, the Company's borrowing capacity with the FHLB-PGH was \$685,916 and \$916,675, respectively.

(In Thousands)

The following represents the amount of collateral pledged to the FHLB-PGH, and the maximum amount of collateral pledged is as follows:

| | December 31, 2015 | Maximum during 2015 | December 31 2014 | Maximum during 2014 |
|----------------|----------------------|------------------------|---------------------|------------------------|
| Carrying value | \$496,789 | \$498,253 | \$— | \$106,609 |
| Fair value | 531,031 | 544,091 | — | 114,763 |

The amount of interest paid to FHLB-PGH on borrowings classified as funding agreements for the years ended December 31, 2015 and 2014 was \$1,304 and \$54, respectively.

OTHER THAN TEMPORARY IMPAIRMENTS ON LOAN-BACKED SECURITIES There were no other-than-temporary impairments recognized on loan-backed securities for the years ended December 31, 2015 and 2014.

REAL ESTATE Investments in real estate consist of the Company's home office property. As of December 31, 2015 and 2014, accumulated depreciation on real estate amounted to \$19,840 and \$18,601, respectively.

ALTERNATIVE ASSETS The following table presents the Company's Alternative assets portfolio as of December 31:

| 2015 | Carrying Value | Unfunded Commitments | Redemption Frequency | Redemption Notice Period |
|---------------------------------|-------------------|-------------------------|-------------------------|-----------------------------|
| Venture capital | \$170,284 | \$132,893 | | |
| MBO | 54,482 | 74,197 | | |
| Distressed | 48,041 | 25,494 | | |
| Real asset | 56,586 | 59,790 | | |
| Mezzanine | 19,412 | 15,013 | | |
| Infrastructure* | 18,684 | 153 | Semi-annually | 30 days |
| Hedge funds | 40,798 | 0 | Monthly | 5 - 90 days |
| Secondaries | 7,179 | 12,158 | | |
| Fund of funds | 15,156 | 4,495 | | |
| Senior mezzanine | 10,381 | 8,646 | | |
| Direct lending | 9,234 | 2,179 | | |
| Total Alternative Assets | \$450,237 | \$335,018 | | |

* Redemption option only applies to one infrastructure fund (Value = \$7,538; Unfunded Commitment = \$0)

| 2014 | Carrying Value | Unfunded Commitments | Redemption Frequency | Redemption Notice Period |
|---------------------------------|-------------------|-------------------------|-------------------------|-----------------------------|
| Venture capital | \$125,267 | \$ 87,161 | | |
| MBO | 45,374 | 29,083 | | |
| Distressed | 44,430 | 18,744 | | |
| Real asset | 52,021 | 37,404 | | |
| Mezzanine | 23,932 | 19,934 | | |
| Infrastructure* | 20,296 | 133 | Semi-annually | 30 days |
| Hedge funds | 48,027 | — | Monthly | 5 days |
| Secondaries | 7,150 | 2,643 | | |
| Fund of funds | 15,935 | 6,775 | | |
| Senior mezzanine | 7,482 | 10,931 | | |
| Direct lending | 8,154 | 3,967 | | |
| Total Alternative Assets | \$398,068 | \$216,775 | | |

* Redemption option only applies to one infrastructure fund (Value = \$8,071; Unfunded Commitment = \$0)

(In Thousands)

The investment values are provided per the partnerships' capital statements. The Company has reviewed events that have occurred since the date the values were calculated and has determined that no adjustments to the calculated values are necessary. With the exception of four open-ended investments within the portfolio, the Company's interest cannot be redeemed. Instead, distributions from each fund result from the liquidation of the underlying assets. The period over which unredeemable investments are expected to be liquidated ranges from 5 to 10 years.

As of December 31, 2015, none of these investments exceed 10% of the Company's admitted assets. The Company recognized realized losses of \$5,340 and \$1,551 for the years ended December 31, 2015 and 2014, respectively, associated with other-than-temporary impairments of certain partnership investments.

The Company recognized realized gains of \$283 and \$408 for the years ended December 31, 2015 and 2014, respectively, associated with redemptions from hedge fund investments.

OTHER INVESTED ASSETS The components of other invested assets as of December 31, 2015 and 2014 were as follows:

| | 2015 | 2014 |
|--------------------------------------|------------------|------------------|
| Derivatives | \$ 59,602 | \$ 62,995 |
| LIHTC | 66,582 | 52,627 |
| Other invested assets — affiliated | 353,121 | 340,172 |
| Other invested assets — unaffiliated | 1,855 | 2,230 |
| Total other invested assets | \$481,160 | \$458,024 |

Refer to Note 6 for discussion on Derivatives. Other invested assets-affiliated, represents the Company's investment in its subsidiary, ISP and notes receivable held by the Company from JMS, a subsidiary of ISP. Refer to Note 11 for additional discussion on Other invested assets-affiliated.

Low Income Housing Tax Credits The Company has no LIHTC properties under regulatory review at December 31, 2015 and 2014. There were no write-downs due to forfeiture of eligibility and there were no impairments during the years ended December 31, 2015 or 2014.

Commitments of \$21,777 and \$2,559 have been recorded in other liabilities as of December 31, 2015 and 2014, respectively. The Company has unexpired tax credits with remaining lives ranging between 8-13 years and required holding periods for its LIHTC investments between 11-16 years.

(In Thousands)

NET INVESTMENT INCOME AND REALIZED CAPITAL GAINS/ (LOSSES) The following table summarizes the major categories of net investment income for the years ended:

| December 31, | 2015 | 2014 |
|------------------------------|------------------|------------------|
| Income: | | |
| Bonds and preferred stock | \$436,133 | \$422,614 |
| Common stocks — affiliated | 46,600 | 10,500 |
| Unaffiliated | 9,930 | 2,092 |
| Real estate | 2,760 | 2,760 |
| Policy loans | 14,810 | 15,202 |
| Alternative assets | 43,641 | 35,282 |
| Other invested assets | 18,279 | 31,007 |
| Other | 768 | 490 |
| Derivatives | 9,198 | 11,295 |
| IMR amortization | (1,728) | (2,305) |
| Total investment income | 580,391 | 528,937 |
| Expenses: | | |
| Surplus note interest | 28,731 | 28,718 |
| Depreciation of real estate | 1,240 | 973 |
| Other investment expenses | 18,576 | 18,880 |
| Total investment expenses | 48,547 | 48,571 |
| NET INVESTMENT INCOME | \$531,844 | \$480,366 |

During 2015 and 2014, proceeds from sales of bonds, preferred stock, and common stocks, and related gross realized gains and losses on those sales were as follows for the years ended December 31:

| | 2015 | | | 2014 | | |
|-----------------|--------------------------------|-------------------------------------|--------------------------------------|--------------------------------|-------------------------------------|--------------------------------------|
| | Proceeds From Sales | Gross Realized Gains | Gross Realized Losses | Proceeds From Sales | Gross Realized Gains | Gross Realized Losses |
| Bonds | \$547,690 | \$34,816 | \$11,693 | \$1,272,076 | 56,171 | 13,727 |
| Preferred stock | 10,288 | — | 249 | 7,582 | 135 | — |
| Common stock | 66,265 | 546 | — | 11,276 | 44 | 188 |

In addition, during the years ended December 31, 2015 and 2014, the Company recognized realized losses of \$2,358 and \$0, respectively, related to the impairment of debt securities.

There was no nonadmitted accrued investment income at December 31, 2015 and 2014, respectively.

Realized capital gains/ (losses) are reported net of federal income taxes and amounts transferred to the IMR as follows for the years ended:

| December 31, | 2015 | 2014 |
|---|-----------------|-----------------|
| Realized capital gains/(losses) | \$47,082 | \$67,205 |
| Less: | | |
| Amount transferred to IMR (net of related taxes of \$(26,710) in 2015 and \$(23,440) in 2014) | 9,641 | 19,402 |
| Income tax effect on realized capital gains/(losses) | 26,710 | 30,405 |
| NET REALIZED CAPITAL GAINS/(LOSSES) | \$10,731 | \$17,398 |

(In Thousands)

Portions of realized capital gains and losses that were determined to be interest related were transferred to the IMR.

The Company did not sell any securities with the NAIC's designation 3 or below during the years ended December 31, 2015 and 2014 that were reacquired within 30 days of the sale date.

STRUCTURED NOTES The following table represents structured notes held by the Company as of December 31:

2015

| CUSIP Identification | Actual Cost | Fair Value | Book/Adjusted Carrying Value | Mortgage-Referenced Security (Y/N) |
|-----------------------------|--------------------|-------------------|-------------------------------------|---|
| 3136F9RQ8 | \$ 1,294 | \$ 1,564 | \$ 1,423 | N |
| 912810FD5 | 182 | 236 | 135 | N |
| 912828C99 | 51,317 | 50,454 | 51,115 | N |
| 912828WU0 | 19,575 | 19,026 | 19,610 | N |

2014

| CUSIP Identification | Actual Cost | Fair Value | Book/Adjusted Carrying Value | Mortgage-Referenced Security (Y/N) |
|-----------------------------|--------------------|-------------------|-------------------------------------|---|
| 3136F9RQ8 | \$ 1,294 | \$ 1,561 | \$ 1,396 | N |
| 912810FD5 | 182 | 248 | 181 | N |
| 912828C99 | 51,317 | 50,110 | 51,181 | N |
| 912828WU0 | 48,937 | 48,154 | 48,847 | N |

Note 4. RESERVES AND FUNDS FOR PAYMENT OF ANNUITY BENEFITS

The Company's separate accounts are non-guaranteed. The withdrawal characteristics of the Company's annuity actuarial reserves and deposit-type contracts are illustrated below as of December 31:

| 2015 | General Account | Separate Account | Total | % of Total |
|--|------------------------|-------------------------|--------------------|-------------------|
| Subject to discretionary withdrawal-with adjustments: | | | | |
| With fair value adjustment | \$ — | \$ — | \$ — | —% |
| At book value less surrender charges | 462,848 | — | 462,848 | 5% |
| At fair value | — | 5,861,942 | 5,861,942 | 65% |
| Subtotal | 462,848 | 5,861,942 | 6,324,790 | 70% |
| At book value — without adjustment | 1,454,495 | — | 1,454,495 | 15% |
| Not subject to discretionary withdrawal | 1,419,965 | 316,908 | 1,736,873 | 18% |
| Total annuity reserves and deposit liabilities gross | 3,337,308 | 6,178,850 | 9,516,158 | 100% |
| Less: reinsurance ceded | (4,132) | — | (4,132) | |
| TOTAL ANNUITY RESERVES AND DEPOSIT LIABILITIES, NET | \$3,333,176 | \$6,178,850 | \$9,512,026 | |

(In Thousands)

| 2014 | General Account | Separate Account | Total | % of Total |
|--|--------------------|--------------------|--------------------|------------|
| Subject to discretionary withdrawal-with adjustments: | | | | |
| With fair value adjustment | \$ — | \$ — | \$ — | —% |
| At book value less surrender charges | 523,283 | — | 523,283 | 6% |
| At fair value | — | 5,754,931 | 5,754,931 | 64% |
| Subtotal | 523,283 | 5,754,931 | 6,278,214 | 70% |
| At book value — without adjustment | 1,416,062 | — | 1,416,062 | 16% |
| Not subject to discretionary withdrawal | 984,916 | 317,429 | 1,302,345 | 14% |
| Total annuity reserves and deposit liabilities gross | 2,924,261 | 6,072,360 | 8,996,621 | 100% |
| Less: reinsurance ceded | (4,039) | — | (4,039) | |
| TOTAL ANNUITY RESERVES AND DEPOSIT LIABILITIES, NET | \$2,920,222 | \$6,072,360 | \$8,992,582 | |

The following summarizes total annuity actuarial reserves and liabilities for deposit-type contracts as of December 31:

| | 2015 | 2014 |
|---|--------------------|--------------------|
| Statutory Statements of Admitted Assets, Liabilities and Surplus: | | |
| Policyholders' reserves — group annuities | \$ 261,356 | \$ 279,343 |
| Policyholders' reserves — individual annuities | 2,100,475 | 2,110,245 |
| Liabilities for deposit-type contracts | 947,337 | 502,500 |
| VACARVM reserves | 24,008 | 28,134 |
| Subtotal | 3,333,176 | 2,920,222 |
| Separate Account Annual Statement: | | |
| Annuities | 6,178,717 | 6,072,208 |
| Supplementary contracts with life contingencies | 118 | 136 |
| Other annuity contract-deposit-funds | 15 | 16 |
| Subtotal | 6,178,850 | 6,072,360 |
| TOTAL RESERVES | \$9,512,026 | \$8,992,582 |

As of December 31, 2015 the Company has recorded reserves of \$450,299 related to outstanding borrowings from the FHLB-PGH classified as funding agreements. There were no outstanding borrowings as of December 31, 2014.

The Company has variable annuity contracts containing GMDB provisions that provide a specified minimum return upon death as follows:

RETURN OF PREMIUM provides the greater of the account value or total deposits made to the contract less any partial withdrawals and assessments, which is referred to as “net purchase payments.” This guarantee is a standard death benefit on all individual variable annuity products.

STEP-UP provides a variable death benefit equal to the greater of the account value and the highest variable account value adjusted for withdrawals and transfers from any prior contract anniversary date.

RISING FLOOR provides a variable death benefit equal to the greater of the current account value and the variable purchase payments accumulated at a set rate and adjusted for withdrawals and transfers.

(In Thousands)

The following table summarizes the account values and net amount at risk (death benefit in excess of account value), net of reinsurance for variable annuity contracts with guarantees invested in the separate account as of December 31:

| | 2015 | 2014 |
|--------------------|-------------|-------------|
| Account value | \$6,131,714 | \$6,039,877 |
| Net amount at risk | 127,648 | 48,961 |

The Company has variable annuity contracts that have GMAB and GMAB/GMWB Rider options. The GMAB provides for a return of principal at the end of a ten-year period. The GMAB/GMWB combination rider allows for guaranteed withdrawals from a benefit base after a selected waiting period. The GMWB riders are also available with inflation or death benefit protection. The benefit base is calculated as the maximum of principal increase at a roll up rate less any partial withdrawals during the accumulation phase, the current account value, and the highest anniversary value over the first ten years. The withdrawal amount is stated as a percentage of the benefit base and varies based on whether the annuitant selects lifetime withdrawals or a specified period. One version of this rider has an inflation adjustment applied to the Guaranteed Withdrawal Amount.

The following table summarizes the account values for the different benefit types as of December 31, 2015:

| Rider Type | Contracts | Fund Value | Cash Value |
|------------------|---------------|--------------------|--------------------|
| GMAB | 1,641 | \$ 179,155 | \$ 170,432 |
| GMWB w/inflation | 12,630 | 1,991,421 | 1,935,732 |
| GMAB/GMWB | 16,104 | 2,647,553 | 2,564,041 |
| GMWB w/ DB | 934 | 140,841 | 133,117 |
| Total | 31,309 | \$4,958,970 | \$4,803,322 |

The following table summarizes the account values for the different benefit types as of December 31, 2014:

| Rider Type | Contracts | Fund Value | Cash Value |
|------------------|---------------|--------------------|--------------------|
| GMAB | 1,490 | \$ 168,684 | \$ 160,262 |
| GMWB w/inflation | 11,818 | 1,889,717 | 1,835,481 |
| GMAB/GMWB | 15,629 | 2,592,078 | 2,502,167 |
| GMWB w/ DB | 803 | 120,898 | 113,644 |
| Total | 29,740 | \$4,771,377 | \$4,611,554 |

Reserves for living and death benefits are based on the methodology specified in Actuarial Guideline XLIII (VACARVM), which specifies the final reserve as the greater of standard and stochastic scenarios floored at the basic adjusted reserve and cash value. The standard scenario is based on a single path, deterministic projection with stipulated assumptions. The stochastic scenario is based on the Conditional Tail Expectation (“CTE”) 70% of 1000 stochastically generated interest rate scenarios. Prudent estimate assumptions including margins for uncertainty are used to calculate the stochastic amount. Key assumptions needed in valuing the liability include full withdrawals, partial withdrawals, mortality, the Consumer Price Index, investment management fees and revenue sharing, expenses, fund allocations and other policyholder behavior. In addition, a method for projecting interest rates and equity returns is required. The stochastic process also requires the projection of in-force general account assets, assets from reinvested cash flows and in-force hedge assets that support the liabilities. The key assumptions needed in valuing the assets include reinvestment asset mix, reinvestment credit spreads, default rates, implied volatility and swap interest rates. At December 31, 2015 and 2014, the standard scenario was the greater of the two measures and was used as the final reserve. The final reserve balance for policies that fall within the scope of Actuarial Guideline XLIII, which covers both Living and Death Benefit guarantees, is \$5,985,327 and \$5,885,362, as of December 31, 2015 and 2014, respectively. During 2015 and 2014, as a result of the annual assumption review, there was a release of reserves of \$100 and \$0, respectively.

Note 5. SEPARATE ACCOUNTS

Separate Accounts Registered with the SEC The Company maintains separate accounts, which are registered with the Securities Exchange Commission (“SEC”), for its individual variable life and annuity products with assets of \$6,894,442 and \$6,854,843 at December 31, 2015 and 2014, respectively. The assets for these separate accounts, which are carried at fair value, represent investments in shares of the Company’s Penn Series Funds and other non-proprietary funds.

Separate Accounts Not Registered with the SEC The Company also maintains separate accounts, which are not registered with the SEC, with assets of \$323,396 and \$324,225 at December 31, 2015 and 2014, respectively. While the product itself is not registered with the SEC, the underlying assets are comprised of SEC registered mutual funds. The assets in these separate accounts are carried at fair value.

Information regarding the Separate accounts of the Company, all of which are nonguaranteed, is as follows:

| | 2015 | 2014 |
|---|------------|------------|
| Premiums considerations and deposits | \$ 493,263 | \$ 509,356 |
| Reserves at December 31, at market value | 7,039,100 | 6,986,569 |
| Subject to discretionary withdrawal at market value | 7,039,100 | 6,986,569 |

The following table reconciles the amounts transferred to and from the separate accounts as reported in the financial statements of the separate accounts to the amount reported in the Statements of Income for the year ended December 31:

| | 2015 | 2014 |
|---|-----------|-----------|
| Transfers as reported in the financial statements of the separate accounts: | | |
| Transfers to separate accounts | \$493,263 | \$509,356 |
| Transfers from separate accounts | 382,347 | 358,141 |
| Transfers as reported in the Statements of Income | \$110,916 | \$151,215 |

The Company utilizes separate accounts to record and account for assets and liabilities for particular lines of business and transactions. For the current reporting year, the Company reported assets and liabilities from variable life and annuity product lines into a separate account.

The assets of the separate accounts, which are legally insulated from the general account, are comprised of the following product mix as of December 31:

| Product Description | 2015 | 2014 |
|--------------------------------------|-------------|-------------|
| Enhanced Deferred Individual Annuity | \$5,622,325 | \$5,489,239 |
| Single Life Variable Universal Life | 601,078 | 623,332 |
| Basic Deferred Individual Annuity | 402,107 | 438,453 |
| Joint Life Variable Universal Life | 268,932 | 303,819 |
| Deferred Group Annuity | 323,396 | 324,225 |
| Total | \$7,217,838 | \$7,179,068 |

Certain separate account liabilities are guaranteed by the general account.

As of December 31, 2015 and 2014, the general account of the Company had a maximum guarantee for separate account liabilities of \$360,974 and \$142,682, respectively. To compensate the general account for the risk taken, the separate account paid risk charges to the general account totaling \$49,294 and \$42,258 for the years ended December 31, 2015 and 2014, respectively and \$149,273 for the four-year period between 2012 and 2015.

(In Thousands)

For the years ended December 31, 2015 and 2014, the general account of the Company has paid \$681 and \$443, respectively, towards separate account guarantees, and \$4,912 cumulatively over the last five years.

Note 6. DERIVATIVES

The Company utilizes derivatives to achieve its risk management goals. Exposure to risk is monitored and analyzed as part of the Company's asset/liability management process, which focuses on risks that impact liquidity, capital, and income. The Company may enter into derivative transactions to hedge exposure to interest rate, credit, liability, currency, and cash flow risks. The Company uses forward contracts, swaps, futures, options, and caps to hedge these risks.

When entering into a derivative transaction, there are several risks, including but not limited to basis risk, credit risk, and market risk. Basis risk is the exposure to loss from imperfectly matched positions, and is monitored and minimized by modifying or terminating the transaction. Credit risk is the exposure to loss as a result of default or a decline in credit rating of a counterparty. Credit risk is addressed by establishing and monitoring guidelines on the amount of exposure to any particular counterparty. Market risk is the adverse effect that a change in interest rates, currency rates, implied volatility rates, or a change in certain equity indexes or instruments has on the value of a financial instrument. The Company manages the market risk by establishing and monitoring limits as to the types and degree of risk that may be undertaken. Also, the Company requires that an International Swaps and Derivatives Association Master agreement govern all Over-the-Counter ("OTC") derivative contracts. In addition, as a result of Dodd Frank Title VII, interest rate swaps are now centrally cleared through an exchange.

The following table presents the notional values, fair values and carrying values of derivative instruments designated and qualifying as hedging instruments. Derivative instruments with carrying values showing a gain are reported in other invested assets. Derivative instruments with carrying values showing a loss are reported in other liabilities.

Derivative Instruments Designated and Qualifying as Hedging Instruments

| December 31, | 2015 | | | | | | 2014 | | | | | |
|--|-----------|--------------------|-----------------|-------------------|---------------------|-----------------------|-----------|--------------------|-----------------|-------------------|---------------------|-----------------------|
| | Number | Notional Value | Fair Value Gain | Fair Value (Loss) | Carrying Value Gain | Carrying Value (Loss) | Number | Notional Value | Fair Value Gain | Fair Value (Loss) | Carrying Value Gain | Carrying Value (Loss) |
| Cash flow hedges: | | | | | | | | | | | | |
| Equity options | 64 | \$1,579,347 | \$33,285 | \$— | \$50,011 | \$— | 44 | \$ 950,163 | \$44,183 | \$— | \$30,140 | \$— |
| Currency swaps | 3 | 17,266 | 1,323 | — | 1,056 | — | 7 | 39,086 | 3,054 | (224) | 1,731 | — |
| Interest rate swaps | 1 | 50,000 | — | (849) | — | — | — | — | — | — | — | — |
| Fair value hedges: | | | | | | | | | | | | |
| Interest rate swaps | 2 | 45,000 | — | (3,608) | — | — | 1 | 25,000 | — | (2,938) | — | — |
| Total designated and qualifying as hedges | 70 | \$1,691,613 | \$34,608 | \$(4,457) | \$51,067 | \$— | 52 | \$1,014,249 | \$47,237 | \$(3,162) | \$31,871 | \$— |

The following table presents the notional and fair values of derivative financial instruments not designated and not qualifying as hedging instruments. Fair values showing a gain are reported in other invested assets. Fair values showing a loss are reported in other liabilities. For the derivative instruments shown below, fair values equal carrying values.

(In Thousands)

Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments

| December 31, | 2015 | | | | 2014 | | | |
|--|--------------|--------------------|----------------|-------------------|--------------|--------------------|-----------------|-------------------|
| | Number | Notional Value | Fair Value | | Number | Notional Value | Fair Value | |
| | | | Gain | (Loss) | | | Gain | (Loss) |
| Interest rate futures | 1,100 | \$ 262,300 | \$ — | \$ (1,837) | 7,101 | \$1,255,727 | \$ 1,401 | \$ (2,279) |
| Credit default swaps | 1 | 5,000 | — | (604) | 1 | 5,000 | — | (591) |
| Equity futures | 1,055 | 106,361 | — | (1,192) | 1,500 | 150,707 | — | (5,705) |
| Foreign currency forwards | — | — | — | — | 1 | 19,103 | 1,489 | — |
| Interest rate swaps | 34 | 3,465,600 | 3,973 | (44,223) | 13 | 1,139,400 | 1,876 | (25,761) |
| Inflation swaps | 2 | 125,000 | — | (11,467) | 2 | 125,000 | — | (10,540) |
| Equity options | 15 | 813,990 | 2,450 | (3,395) | 15 | 628,100 | 26,358 | (1,692) |
| Total return swaps | 14 | 569,497 | 2,112 | (32,296) | 4 | 270,472 | — | (22,836) |
| Swaptions | 2 | 170,000 | — | (464) | 5 | 695,000 | — | (930) |
| Treasury forwards | 1 | 20,000 | — | (508) | — | — | — | — |
| Total not designated and not qualifying as hedges | 2,224 | \$5,537,748 | \$8,535 | \$(95,986) | 8,642 | \$4,288,509 | \$31,124 | \$(70,334) |

The impact of derivative instruments reported on the Statements of Income for the years ended December 31, 2015 and 2014, segregated by derivatives designated and qualifying as hedging instruments and derivatives not designated and not qualifying as hedging instruments, is reported in the tables below:

Derivative Instruments Designated and Qualifying as Hedging Instruments

| Years Ended December 31, | 2015 | | 2014 | |
|--------------------------------|------------------------------|--|------------------------------|--|
| | Net Investment Income/(Loss) | Net Investment Gains/(Losses) ¹ | Net Investment Income/(Loss) | Net Investment Gains/(Losses) ¹ |
| Cash flow hedges: | | | | |
| Interest rate swaps | \$ 583 | \$ — | \$ — | \$ — |
| Currency swaps | 150 | 5,106 | 11 | — |
| Fair value hedges: | | | | |
| Interest rate swaps | (1,166) | 5,479 | (231) | — |
| Interest rate futures | — | — | — | 197 |
| Total qualifying hedges | \$ (433) | \$10,585 | \$(220) | \$197 |

1 Net investment gains/ (losses) were transferred to the IMR.

Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments

| YEARS ENDED DECEMBER 31, | 2015 | | 2014 | |
|-----------------------------------|------------------------------|--|------------------------------|--|
| | Net Investment Income/(Loss) | Net Investment Gains/(Losses) ¹ | Net Investment Income/(Loss) | Net Investment Gains/(Losses) ¹ |
| Interest rate futures | \$ — | \$ 8,839 | \$ — | \$ (8,985) |
| Interest rate caps | — | — | — | (4,380) |
| Credit default swaps | (254) | — | (274) | — |
| Equity futures | — | (10,430) | — | (23,293) |
| Foreign currency forwards | — | 2,573 | — | (149) |
| Interest rate swaps | 10,066 | 17,588 | 10,979 | 28,334 |
| Inflation swaps | (2,128) | — | (338) | — |
| Equity options | — | 4,441 | — | 66,303 |
| Total return swaps | 1,947 | (4,846) | 1,148 | (35,976) |
| Swaptions | — | 2,126 | — | 3,581 |
| Total nonqualifying hedges | \$ 9,631 | \$ 20,291 | \$11,515 | \$ 25,435 |

1 \$2,267 and \$538, of the net investment gains/(losses) were transferred to the IMR for the years ended December 31, 2015 and 2014, respectively.

Derivative Instruments Designated and Qualifying as Hedging Instruments

The Company has entered into currency swaps that qualify for hedge accounting. These have been designated as cash flow hedges of cash flows related to foreign currency securities. These currency swaps are used to reduce market risks from changes in foreign exchange rates. The hedging instruments are held at amortized cost. For the currency swaps, the change in value related to foreign exchange fluctuations is recognized as an unrealized gain or loss, as applicable. The change in unrealized capital gains/(losses) for these currency swaps designated and qualifying as hedging instruments for the years ended December 31, 2015 and 2014 were \$(674) and \$3,494 respectively.

The company has entered into an interest rate swap that qualifies for hedge accounting. The swap has been designated as a cash flow hedge of cash flows related to the variability of interest rate payments associated with holdings of 3-month LIBOR variable rate fixed income securities. The hedging instrument is held at amortized cost. The effective portion of the hedge flows through the income statement. At termination, the gain or loss on the derivative is transferred to the IMR and amortized into income over the remaining life of the derivative.

Derivative instruments used in cash flow hedges that meet the criteria of a highly effective hedge are valued and reported in a manner that is consistent with the hedged asset or liability. The maximum length of time over which the Company is hedging its exposure to the variability in future cash flows is 16 years.

The Company has purchased equity options in the form of call spreads that qualify for hedge accounting. These have been designated as cash flow hedges of cash flows related to the annual return of the S&P 500 Index. These call spreads are used to hedge the increase in liability associated with indexed credits on IUL and VUL policies. As these are derivatives in a highly effective hedge, they are carried at cost in a manner consistent with the firm commitment being hedged. At termination, a realized gain amount, net of the cost basis, is recognized within benefits paid to policyholders and beneficiaries on the Statements of Income, consistent with the change in liability associated with the account value. In the event that the hedge fails to qualify as being highly effective at any of the accounting measurement points, the hedge will be considered ineffective and the derivative will be marked to market and the associated change will be recognized as unrealized gain/(loss). At the time of exercise or expiration of the derivative, the associated realized gain or loss will flow through net investment gain/(loss) on the income statement.

The company has entered into interest rate swaps that qualify for hedge accounting. The swaps have been designated as a fair value hedge of changes in the market value of three bonds in the corporate bond portfolio due to changes in interest rates. The effective portion of the hedges flows through the income statement. At termination, the change in the fair value of the derivatives flow through the income statement; the change in the fair value of the bonds will be used to adjust the book basis of the bonds and the remaining amount will be amortized over the remaining life of the bonds. The gain or loss of the derivatives at termination will be amortized through IMR over the remaining life of the hedged asset.

During the year ended December 31, 2015, the Company entered into and subsequently terminated fair value hedge accounting for an interest rate swap. When the derivative instrument was closed it resulted in a realized gain of \$5,479 which was transferred to the IMR and will be amortized into income over the remaining duration of the hedged asset.

During the year ended December 31, 2014, the Company entered into fair value hedge accounting for two interest rate futures. Hedge accounting for one such hedge was subsequently terminated when the derivative instrument was closed and resulted in a realized gain of \$197. Hedge accounting for the other such hedge was subsequently terminated when the derivative instrument was closed, which was proven to be ineffective, resulting in a realized gain of \$59. The realized gains for both hedges were transferred to the IMR and are being amortized over the duration of the derivative instruments.

Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments

The Company enters into interest rate caps, interest rate and equity futures, credit default swaps, forward contracts, interest rate swaps, inflation swaps and equity options that do not qualify for hedge accounting.

(In Thousands)

These instruments are carried at fair value and are classified as either other invested assets or other liabilities in the Statements of Admitted Assets, Liabilities and Surplus. The Company's use of interest rate caps is designed to manage risk associated with rising interest rates. Credit default swaps protect the Company from a decline in credit quality of a specified security resulting in bankruptcy or the failure to pay. The Company may use "to be announced" forward contracts to gain exposure to the investment risk and return of mortgage-backed securities.

The Company uses interest rate swaps, interest rate futures and swaptions to reduce market risks from changes in interest rates; the Company uses inflation swaps as an economic hedge to reduce inflation risk associated with inflation-indexed liabilities.

Total return swaps and equity futures are used to hedge the company's liability risk exposure to declines in the equity markets.

Foreign currency forwards are used to hedge the risk embedded in the Company's investment in Euro-denominated alternative assets.

The Company offers IUL products which have embedded options with guaranteed returns. The Company uses equity options in the form of call spread options for protection from rising equity levels and rising volatility.

The change in unrealized capital gains/(losses) for derivative instruments not designated and not qualifying as hedging instruments are as follows for the years ended December 31:

| | 2015 | 2014 |
|--------------------------|-------------------|------------------|
| Interest rate futures | \$ (960) | \$ 2,338 |
| Interest rate caps | — | 4,380 |
| Credit default swaps | (13) | 227 |
| Equity futures | 4,513 | (5,612) |
| Foreign currency forward | (1,489) | 1,893 |
| Interest rate swaps | (16,725) | 41,970 |
| Inflation swaps | (927) | (8,733) |
| Equity options | (13,479) | (33,024) |
| Total return swaps | (7,348) | 10,348 |
| Swaptions | (208) | 785 |
| Treasury forwards | (508) | — |
| Total | \$(37,144) | \$ 14,572 |

The Company offers a variety of variable annuity contracts with GMAB or GMWB (described further in Note 4). The contractholders may elect to invest in equity funds. Adverse changes in the equity markets expose the Company to losses if the changes result in contractholder's account balances falling below the guaranteed minimum. To mitigate the risk associated with these liabilities, the Company enters into equity futures. The changes in value of the futures will offset a portion of the changes in the annuity accounts relative to changes in the equity market.

CREDIT RISK

The Company is exposed to credit related losses in the event of non-performance by counterparties to derivative financial instruments. In order to minimize credit risk, the Company and its derivative counterparties require collateral to be posted in the amount owed under each transaction, subject to threshold and minimum transfer amounts that are functions of the counterparty's credit rating. As of December 31, 2015 and 2014, the Company was fully collateralized thereby eliminating the potential for an accounting loss. Additionally, the agreements with the counterparties allow for contracts in a positive position to be offset by contracts in a negative position. This right of offset also reduces the Company's exposure. As of December 31, 2015 and 2014, the Company pledged collateral of \$128,318 and \$6,731, respectively, in the form of securities and cash. The cash received from held collateral is invested in an interest bearing money market fund and is reflected as a short-term investment.

As of December 31, 2015 and 2014, the Company pledged collateral for futures contracts of \$10,134 and \$16,169, respectively, in the form of cash. Notional or contractual amounts of derivative financial instruments provide a measure of involvement in these types of transactions and do not represent the amounts exchanged between the parties engaged in the transaction. The amounts exchanged are determined by reference to the notional amounts and other terms of the derivative financial instruments.

Note 7. FAIR VALUE OF FINANCIAL INSTRUMENTS AND OFF-BALANCE-SHEET RISK

FAIR VALUE MEASUREMENT Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurement is based on assumptions market participants would make in pricing an asset or liability. Inputs to valuation techniques to measure fair value are prioritized by establishing a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to prices derived from unobservable inputs. An asset or liability's classification within the fair value hierarchy is based on the lowest level of significant input to its fair value measurement. The Company has categorized its assets and liabilities into the three-level fair value hierarchy based upon the priority of the inputs. The following summarizes the types of assets and liabilities included within the three-level hierarchy:

- Level 1 Fair value is based on unadjusted quoted market prices in active markets for identical assets or liabilities that are accessible at the measurement date. These generally provide the most reliable evidence and are used to measure fair value whenever available. Active markets are defined as having the following for the measured asset/liability: i) many transactions, ii) current prices, iii) price quotes not varying substantially among market makers, iv) narrow bid/ask spreads and v) most information publicly available. Prices are obtained from readily available sources for market transactions involving identical assets and liabilities.
- Level 2 Fair value is based on significant inputs, other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability through corroboration with observable market data. Prices for assets classified as Level 2 are primarily provided by an independent pricing service using observable inputs. In circumstances where prices from pricing services are reviewed for reasonability but cannot be corroborated to observable market data as noted above, these security values are recorded in Level 3 in the fair value hierarchy.
- Level 3 Fair value is based on significant inputs that are unobservable for the asset or liability. These inputs reflect the Company's assumptions about the assumptions market participants would use in pricing the asset or liability. These are typically less liquid fixed maturity securities with very limited trading activity. Prices are determined using valuation methodologies such as option pricing models, discounted cash flow models, market approach and other similar techniques. Prices may be based upon non-binding quotes from brokers or other market makers that are reviewed for reasonableness, based on the Company's understanding of the market but are not further corroborated with other additional observable market information.

The determination of fair value, which for certain assets and liabilities is dependent on the application of estimates and assumptions, can have a significant impact on the Company's results of operations. The following sections describe the valuation methodologies used to determine fair values as well as the key estimates and assumptions surrounding certain assets and liabilities, measured at fair value on a recurring basis, that could have a significant impact on the Company's results of operations or involve the use of significant unobservable inputs.

The fair value process is monitored by an internal Valuation Group which meets at least quarterly. The Valuation Group consists of financial and investment professionals and utilizes additional subject matter experts as applicable. The purpose of the Valuation Group is to monitor the Company's asset valuation policies and procedures by ensuring objective and reliable valuation practices and pricing of financial instruments, as well as addressing fair valuation issues, changes to valuation methodologies and pricing sources. To assess the continuing appropriateness of third party pricing service security valuations, the Valuation Group regularly monitors the prices and reviews price variance reports. In addition, the Company performs an initial and ongoing review of the third party pricing services methodologies, reviews inputs and assumptions used for a sample of securities on a periodic basis. Pricing challenges are raised on valuations considered not reflective of market and are monitored by the Valuation Group.

BONDS The fair values of the Company's debt securities are generally based on quoted market prices or prices obtained from independent pricing services. In order to validate reasonability, prices are reviewed by internal investment professionals through comparison with directly observed recent market trades or color or by comparison of significant inputs used by the pricing service to the Company's observations of those inputs in the market. Consistent with the fair value hierarchy described above, securities with quoted market prices or corroborated valuations from pricing services are generally reflected within Level 2. Inputs considered to be standard for valuations by the independent pricing service include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data and industry and economic events. In circumstances where prices from pricing services are reviewed for reasonability but cannot be corroborated to observable market data as noted above, these security values are recorded in Level 3 in the Company's fair value hierarchy.

In circumstances where market data such as quoted market prices or vendor pricing is not available, internal estimates based on significant observable inputs are used to determine fair value. This category also includes fixed income securities priced internally. Inputs considered include: public debt, industrial comparables, underlying assets, credit ratings, yield curves, type of deal structure, collateral performance, loan characteristics and various indices, as applicable. Also included in Level 2 are private placement securities. Inputs considered are: public corporate bond spreads, industry sectors, average life, internal ratings, security structure, liquidity spreads, credit spreads and yield curves, as applicable. If the discounted cash flow model incorporates significant unobservable inputs, these securities would be reflected within Level 3 in the Company's fair value hierarchy.

In circumstances where significant observable inputs are not available, estimated fair value is calculated internally by using unobservable inputs. These inputs reflect the Company's assumptions about the inputs market participants would use in pricing the asset, and are therefore included in Level 3 in the Company's fair value hierarchy. Circumstances where observable market data is not available may include events such as market illiquidity and credit events related to the security.

The Company's Level 3 debt securities generally include certain privately placed commercial mortgage backed, asset backed trust preferred, public debt and certain private debt securities priced internally based on observable and unobservable inputs. Under certain conditions, the Company may conclude pricing information received from third party pricing services is not reflective of market activity and may over-ride that information with an internally developed valuation that utilizes market information and activity. As of December 31, 2015 and 2014, there were no debt securities carried at fair value that were valued in this manner.

Significant inputs used in valuing the Company's Level 3 debt securities include: issue specific credit adjustments, illiquidity premiums, estimation of future collateral performance cash flows, default rate assumptions, acquisition cost, market activity for securities considered comparable and non-binding quotes from certain market participants. Certain of these inputs are considered unobservable, as not all market participants will have access to this data.

The methodologies followed for valuing the Company's significant Level 3 debt securities include:

- Commercial mortgage, residential mortgage and asset backed securities — These assets are valued based upon broker quotes which are updated regularly. The quoted valuation is based upon a discounted cash flow model and the assumptions underlying the model include swap curve rates, prepayment and default assumptions and an illiquidity premium. On a periodic basis, management reviews the underlying assumptions with the quoting broker and reviews the final quotes for reasonableness.
- Asset backed trust preferred securities — The process used to value these assets consists of determining the current market price and credit spread of the underlying floating rate security that will be received at maturity of the trust. That value is then discounted based upon a rate consisting of the applicable swap yield to maturity, the discount margin and an illiquidity premium established by management.

EQUITY SECURITIES Equity securities consist principally of investments in common and preferred stock of publicly traded companies, exchange traded funds, closed-end funds, and FHLB-PGH capital stock. The fair values of most publicly traded equity securities are based on quoted market prices in active markets for identical assets and are classified within Level 1 in the Company's fair value hierarchy. The fair values of non-exchange traded preferred

equity securities are based on prices obtained from independent pricing services and, in order to validate reasonability, are compared with recent market trades we have directly observed. Accordingly, these securities are classified within Level 2 in the Company's fair value hierarchy. Fair value for the FHLB capital stock approximates par value and is classified within Level 3 of the Company's fair value hierarchy.

CASH AND SHORT-TERM INVESTMENTS Short-term investments carried at Level 1 consist of money market funds and investments purchased with maturities of greater than three months and less than or equal to 12 months. These are carried at amortized cost and approximate fair value.

DERIVATIVE INSTRUMENTS Derivatives instruments not qualifying as an effective hedge with a positive fair value are recorded as other invested assets. Derivatives instruments not qualifying as an effective hedge with negative fair values are reported as other liabilities. The fair values of derivative contracts are determined based on quoted prices in active exchanges or prices provided by counterparties, exchanges or clearing members as applicable, utilizing valuation models. The fair values of derivative contracts can be affected by changes in interest rates, foreign exchange rates, commodity prices, credit spreads, market volatility, expected returns and liquidity as well as other factors. In order to validate reasonability, prices are reviewed by our internal investment professionals through comparison with directly observed recent market trades, comparison with internal valuations estimated through use of valuation models maintained on an industry standard analytical and valuation platform, or comparison of all significant inputs used by the pricing service to our observations of those inputs in the market. Fair values can also be affected by changes in estimates and assumptions including those related to counterparty behavior used in valuation models.

The Company's exchange traded futures include index futures that are valued using quoted prices in active markets and are classified within Level 1 in our fair value hierarchy. Derivative positions traded in the over-the-counter ("OTC") derivative market are classified within Level 2. These investments include: interest rate swaps, interest rate caps, total return swaps, swaptions, equity options, inflation swaps, forward contracts, and credit default swaps. OTC derivatives classified within Level 2 are valued using models generally accepted in the financial services industry that use actively quoted or observable market input values from external market data providers, broker-dealer quotations, third-party pricing vendors and/or recent trading activity. Refer to Note 6 for additional disclosures regarding derivatives.

SEPARATE ACCOUNT ASSETS Separate account assets primarily consist of mutual funds. The fair value of mutual funds is based upon quoted prices in an active market, resulting in classification within Level 1 of the Company's fair value hierarchy.

(In Thousands)

The following table presents the financial instruments carried at fair value by caption on the Statements of Admitted Assets, Liabilities and Surplus and by valuation hierarchy (as described above).

| December 31, 2015 | FV Level 1 | FV Level 2 | FV Level 3 | Total |
|--|-----------------------|-----------------------|-----------------------|--------------|
| Assets: | | | | |
| Bonds: | | | | |
| Corporate securities | \$ — | \$ 4,759 | \$ — | \$ 4,759 |
| Commercial MBS | — | — | 8,000 | 8,000 |
| Asset-backed securities | — | — | 1,579 | 1,579 |
| Total Bonds | — | 4,759 | 9,579 | 14,338 |
| Common stock — unaffiliated | 75,523 | — | 20,484 | 96,007 |
| Derivatives | | | | |
| Interest rate swaps | — | 3,973 | — | 3,973 |
| Equity options | — | 2,450 | — | 2,450 |
| Total return swaps | — | 2,112 | — | 2,112 |
| Total derivatives | — | 8,535 | — | 8,535 |
| Total investments | 75,523 | 13,294 | 30,063 | 118,880 |
| Separate account assets ⁽¹⁾ | 7,217,838 | — | — | 7,217,838 |
| Total assets | \$7,293,361 | \$ 13,294 | \$30,063 | \$7,336,718 |
| Liabilities: | | | | |
| Derivatives | \$ (3,030) | \$(92,956) | \$ — | \$ (95,986) |
| Total Liabilities | \$ (3,030) | \$(92,956) | \$ — | \$ (95,986) |

(1) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Statements of Admitted Assets, Liabilities and Surplus.

(In Thousands)

The following table presents the financial instruments carried at fair value by caption on the Statements of Admitted Assets, Liabilities and Surplus and by valuation hierarchy (as described above).

| December 31, 2014 | FV Level 1 | FV Level 2 | FV Level 3 | Total |
|--|-----------------------|-----------------------|-----------------------|--------------|
| Assets: | | | | |
| Bonds: | | | | |
| Corporate securities | \$ — | \$ 285 | \$ — | \$ 285 |
| Commercial MBS | — | 3,311 | — | 3,311 |
| Asset-backed securities | — | 9,591 | 1,640 | 11,231 |
| Total Bonds | — | 13,187 | 1,640 | 14,827 |
| Redeemable preferred stock | — | 800 | — | 800 |
| Common stock — unaffiliated | 66,604 | — | 2,592 | 69,196 |
| Derivatives | | | | |
| Interest rate swaps | — | 1,876 | — | 1,876 |
| Interest rate futures | 1,401 | — | — | 1,401 |
| Equity options | — | 26,358 | — | 26,358 |
| Foreign Currency Forwards | — | 1,489 | — | 1,489 |
| Total derivatives | 1,401 | 29,723 | — | 31,124 |
| Total investments | 68,005 | 43,710 | 4,232 | 115,947 |
| Separate account assets ⁽¹⁾ | 7,179,068 | — | — | 7,179,068 |
| Total assets | \$7,247,073 | \$ 43,710 | \$4,232 | \$7,295,015 |
| Liabilities: | | | | |
| Derivatives | \$ (7,984) | \$(62,350) | \$ — | \$ (70,334) |
| Total liabilities | \$ (7,984) | \$(62,350) | \$ — | \$ (70,334) |

SIGNIFICANT TRANSFERS BETWEEN LEVEL 1 AND LEVEL 2 There were no significant transfers between Level 1 and Level 2.

CHANGES IN LEVEL 3 RECURRING FAIR VALUE MEASUREMENTS When a determination is made to classify a financial instrument within Level 3, the determination is based upon the significance of the unobservable parameters to the overall fair value measurement. However, Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources); accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology.

The Company recognizes transfers into Level 3 as of the end of the period in which the circumstances leading to the transfer occurred. The Company recognizes transfers out of Level 3 at the beginning of a period in which the circumstances leading to the transfer occurred.

There were no assets transferred out of Level 3 during 2015. There was one asset that had an NAIC designation downgrade in 2015, requiring that it be carried at the lower of amortized cost or fair value. This has been classified as Level 3. There were no assets transferred in or out of level 3 for the year ended December 31, 2014.

(In Thousands)

The tables below include a rollforward of the Statements of Admitted Assets, Liabilities and Surplus amounts for the years ended December 31, 2015 and 2014 (including the change in fair value), for financial instruments classified by the Company within Level 3 of the valuation hierarchy.

| | Asset-Backed Securities | Common Stock | Commercial MBS | Total Assets |
|--|-------------------------|-----------------|----------------|-----------------|
| Balance January 1, 2015 | \$1,640 | \$ 2,592 | \$ — | \$ 4,232 |
| Transfers in | — | — | 8,000 | 8,000 |
| Transfers out | — | — | — | — |
| Total gains or losses (realized/ unrealized) included in: | | | | |
| Income/(loss) | 17 | — | — | 17 |
| Surplus | 5 | — | — | 5 |
| Amortization/Accretion | — | — | — | — |
| Purchases/(Sales): | | | | |
| Purchases | — | 18,000 | — | 18,000 |
| (Sales) | (83) | (108) | — | (191) |
| Balance December 31, 2015 | \$1,579 | \$20,484 | \$8,000 | \$30,063 |

| | Asset-Backed Securities | Common Stock | Total Assets |
|---|-------------------------|-----------------|-----------------|
| Balance January 1, 2014 | \$1,743 | \$ 971 | \$ 2,714 |
| Transfers in | — | — | — |
| Transfers out | — | — | — |
| Total gains or losses (realized/unrealized) included in: | | | |
| Income/(loss) | 4 | — | 4 |
| Surplus | 4 | — | 4 |
| Amortization/Accretion | — | — | — |
| Purchases/(Sales): | | | |
| Purchases | — | 9,672 | 9,672 |
| (Sales) | (111) | (8,051) | (8,162) |
| Balance December 31, 2014 | \$1,640 | \$ 2,592 | \$ 4,232 |

The following summarizes the fair value, valuation techniques and significant unobservable inputs of the Level 3 fair value measurements that were developed as of December 31, 2015:

| | Fair Value | Valuation Technique | Significant Unobservable Inputs | Rate/Range or weighted avg. |
|-------------------------|------------|--|---------------------------------|-----------------------------|
| Assets: | | | | |
| Investments | | | | |
| Bonds | | | | |
| Asset-backed securities | \$ 1,579 | Broker quote ⁽¹⁾ | Not available | N/A |
| Commercial MBS | 8,000 | Property, appraised and credit support | Not available | N/A |
| Common stock | 971 | Enterprise valuation multiple ⁽²⁾ | Enterprise valuation multiple | 6.0 multiple |
| | 19,513 | Set by issuer — FHLB-PGH ⁽³⁾ | Not available | N/A |
| Total investments | \$30,063 | | | |

(1) Broker quoted fair values on these asset backed securities represent indicative, non-binding quotes developed by a single market maker. The significant inputs are not developed by the Company and are not reasonably available.

(In Thousands)

- (2) The Company estimates the fair value using a model which applies an enterprise valuation multiplier to estimated earnings before income taxes, depreciation, and amortization.
- (3) The par value of capital stock is \$100. The capital stock is issued, redeemed and repurchased at par.

The following tables summarizes the aggregate fair value for all financial instruments and the level within the fair value hierarchy in which the fair value measurements in their entirety fall, for which it is practicable to estimate fair value, at December 31:

| 2015 | Aggregate Fair Value | Admitted Value | Level 1 | Level 2 | Level 3 |
|---------------------------------|-------------------------|-------------------|-----------|-------------|-------------|
| Financial Assets: | | | | | |
| Bonds | \$8,426,266 | \$8,134,957 | \$ 73,900 | \$7,589,325 | \$ 763,041 |
| Redeemable preferred stock | 76,998 | 72,595 | 44,056 | 30,980 | 1,962 |
| Common stock-unaffiliated | 96,007 | 96,007 | 75,523 | — | 20,484 |
| Cash and short-term investments | 245,071 | 245,071 | 245,071 | — | — |
| Derivatives | 43,143 | 59,602 | — | 43,143 | — |
| Separate Account assets | 7,217,838 | 7,217,838 | 7,217,838 | — | — |
| Financial Liabilities: | | | | | |
| Investment-Type Contracts | | | | | |
| Individual annuities | \$2,394,501 | \$2,352,887 | \$ — | \$ — | \$2,394,501 |
| Derivatives | 95,986 | 95,986 | 92,956 | 3,030 | — |
| Separate Account liabilities | 7,217,838 | 7,217,838 | 7,217,838 | — | — |

| 2014 | Aggregate Fair Value | Admitted Value | Level 1 | Level 2 | Level 3 |
|---------------------------------|-------------------------|-------------------|-----------|-------------|-------------|
| Financial Assets: | | | | | |
| Bonds | \$8,302,414 | \$7,528,488 | \$ 18,174 | \$7,681,891 | \$ 602,349 |
| Redeemable preferred stock | 76,033 | 72,905 | 44,875 | 29,976 | 1,182 |
| Common stock-unaffiliated | 69,196 | 69,196 | 66,604 | — | 2,592 |
| Cash and short-term investments | 128,700 | 128,700 | 128,700 | — | — |
| Derivatives | 78,361 | 62,995 | 1,401 | 76,960 | — |
| Separate Account assets | 7,179,068 | 7,179,068 | 7,179,068 | — | — |
| Financial Liabilities: | | | | | |
| Investment-Type Contracts | | | | | |
| Individual annuities | \$2,421,249 | \$2,367,290 | \$ — | \$ — | \$2,421,249 |
| Derivatives | 73,496 | 70,334 | 7,984 | 65,512 | — |
| Separate Account liabilities | 7,179,068 | 7,179,068 | 7,179,068 | — | — |

Note 8. BENEFIT PLANS

The Company maintains both funded and unfunded non-contributory defined benefit pension plans covering all eligible employees. The Company also has other postretirement benefit plans (health care plans) covering eligible existing retirees and limited other eligible employees. The Company uses a measurement date of December 31 for all plans.

PENSION PLANS The Company has both funded and unfunded non-contributory defined benefit pension plans covering all eligible employees. The Company's policy is to fund qualified pension costs in accordance with the Employee Retirement Income Security Act of 1974. The Company may increase its contribution above the minimum based upon an evaluation of the Company's tax and cash positions and the plan's funded status.

(In Thousands)

The Company approved the freezing of benefits under its qualified and Tax Equity and Fiscal Responsibility Act (“TEFRA”) pension plans effective December 31, 2005. Therefore, there no further benefits are accrued for participants.

OTHER POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS The Company provides certain life insurance and health care benefits (“other postretirement benefits”) for its retired employees and agents, and their beneficiaries and covered dependents.

OTHER PLANS The Company has non-qualified deferred compensation plans that permit eligible key employees, producers and trustees to defer portions of their compensation to these plans. Certain Company contributions in excess of allowable qualified plan limits may also be credited to these plans. Company contributions are recorded as expenses and earnings/(losses) on investments are recorded to interest credited to policyholder funds in the Statements of Income. To hedge against volatility for the investment earnings credited, the Company has purchased corporate-owned life insurance contracts.

BENEFIT OBLIGATIONS Accumulated benefit obligations represent the present value of pension benefits earned as of the measurement date based on service and compensation and do not take into consideration future salary increases. Projected benefit obligations for defined benefit plans represent the present value of pension benefits earned as of the measurement date projected for estimated salary increases to an assumed date with respect to retirement, termination, disability or death.

The following table sets forth the plans’ change in projected benefit obligation of the defined benefit pension and other postretirement plans as of December 31:

| | Pension Benefits | | Other Benefits | |
|--|------------------|------------------|-----------------|-----------------|
| | 2015 | 2014 | 2015 | 2014 |
| Change in projected benefit obligation | | | | |
| Projected benefit obligation at beginning of year | \$181,602 | \$159,925 | \$24,827 | \$25,822 |
| Service cost | — | — | 416 | 382 |
| Interest cost | 7,273 | 7,573 | 850 | 1,012 |
| Actuarial loss/(gain) | (7,600) | 22,946 | (2,580) | (492) |
| Benefits paid | (9,084) | (8,843) | (1,490) | (1,897) |
| Change in plan provisions | — | — | — | — |
| Projected benefit obligation at end of year | \$172,191 | \$181,601 | \$22,023 | \$24,827 |

The weighted-average assumptions used to measure the actuarial present value of the projected benefit obligation were as follows at December 31:

| | Pension Benefits | | Other Benefits | |
|-------------------------------|------------------|-------|----------------|-------|
| | 2015 | 2014 | 2015 | 2014 |
| Discount rate | 4.50% | 4.10% | 4.20% | 3.80% |
| Rate of compensation increase | N/A | N/A | N/A | N/A |

(In Thousands)

The assumed health care cost trend rates used in determining the benefit obligation were as follows as of December 31:

| | 2015 | | 2014 | |
|---|--------|---------|--------|---------|
| | Pre-65 | Post-65 | Pre-65 | Post-65 |
| Health care cost trend rate assumed for next year | 7.25% | 7.75% | 7.45% | 6.75% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 5.00% | 5.00% | 5.00% | 5.00% |
| Year that the rate reaches the ultimate trend rate | 2025 | 2025 | 2022 | 2022 |

The discount rate is determined at the annual measurement date of the plans and is therefore subject to change each year. The rate reflects prevailing market rates for high quality fixed-income debt instruments with maturities corresponding to expected duration of the benefit obligations on the measurement date. The rate is used to discount the future cash flows of benefits obligations back to the measurement date.

As of December 31, 2014, the Company changed its mortality assumptions for all plans to reflect the RP-2014 fully generational mortality tables, with modification for projected mortality improvements, in connection with the final updated RP-2014 mortality tables released by the Society of Actuaries in 2014.

PLAN ASSETS The change in plan assets represents a reconciliation of beginning and ending balances of the fair value of the plan assets used to fund future benefit payments. The following table sets forth the change in plan assets as of December 31:

| | Pension Benefits | | Other Benefits | |
|---|------------------|------------------|----------------|-------------|
| | 2015 | 2014 | 2015 | 2014 |
| Change in plan assets: | | | | |
| Fair value of plans assets at beginning of year | \$179,097 | \$175,673 | \$ — | \$ — |
| Actual return on plan assets | 2,277 | 9,609 | — | — |
| Employer contribution | 2,569 | 2,658 | 1,490 | 1,897 |
| Benefits paid | (9,084) | (8,843) | (1,490) | (1,897) |
| Fair value of plan assets at end of year | \$174,859 | \$179,097 | \$ — | \$ — |

The plan assets consist primarily of mutual funds. The fair value of those funds is based upon quoted prices in an active market, resulting in a classification of Level 1.

The following table presents the financial instruments carried at fair value in Company's pension plan asset as of December 31, 2015:

| Asset Category | FV | FV | FV | Total |
|--------------------|------------------|------------|------------|------------------|
| | Level 1 | Level 2 | Level 3 | |
| Equity funds | \$ 84,442 | \$— | \$— | \$ 84,442 |
| Bond funds | 66,215 | — | — | 66,215 |
| Money market funds | 24,202 | — | — | 24,202 |
| Total | \$174,859 | \$— | \$— | \$174,859 |

(In Thousands)

The following table presents the financial instruments carried at fair value in Company's pension plan assets as of December 31, 2014:

| Asset Category | FV Level 1 | FV Level 2 | FV Level 3 | Total |
|-----------------------|-----------------------|-----------------------|-----------------------|------------------|
| Equity funds | \$ 90,395 | \$— | \$— | \$ 90,395 |
| Bond funds | 80,684 | — | — | 80,684 |
| Money market funds | 8,018 | — | — | 8,018 |
| Total | \$179,097 | \$— | \$— | \$179,097 |

The Company's overall investment strategy with respect to pension assets are growth, preservation of principal, preservation of purchasing power and partial immunization through asset/liability matching while maintaining return objective over the long term. To achieve these objectives, the Company has established a strategic asset allocation policy. Plan assets are diversified both by asset class and within each asset class in order to provide reasonable assurance that no single security or class of security will have a disproportionate impact on the plan. The target allocation for 2014 was 50%/50% between equity and bond funds. The target allocation for 2015 was a 40%-60%/ 40%-60% allocation between equity and bond funds. The Company will continue its policy to rebalance the portfolio on an annual basis. Performance of investment managers, liability measurement and investment objectives are reviewed on a regular basis.

The Company's pension plan asset allocation at December 31, 2015 and 2014, and target allocations are as follows:

| Asset Category | 2016 Target Allocation | Percentage of Plan Assets As of December 31, | |
|-----------------------|-----------------------------------|---|---------------|
| | | 2015 | 2014 |
| Equity funds | 40.0% – 60.0% | 48.3% | 50.5% |
| Bond funds | 40.0% – 60.0% | 37.9% | 45.0% |
| Money market funds | 0% | 13.8% | 4.5% |
| Total | 100.0% | 100.0% | 100.0% |

The expected rate of return on plan assets was estimated utilizing a variety of factors including the historical investment returns achieved over a long-term period, the targeted allocation of plan assets and expectations concerning future returns in the marketplace for both equity and debt securities. Lower returns on plan assets result in higher net periodic benefit cost.

AMOUNTS RECOGNIZED IN THE STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND SURPLUS The funded status of the defined benefit plans is a comparison of the projected benefit obligations to the assets related to the respective plan, if any. The difference between the two represents amounts that have been appropriately recognized as expenses in prior periods that appear as the net amount recognized or represent amounts that will be recognized as expenses in the future through the amortization of the unrecognized net actuarial loss, unrecognized prior service costs, and remaining initial transition.

The following table sets forth the funded status of the plans as of December 31, 2015 and 2014 as of the measurement date.

| | Pension Benefits | | Other Benefits | |
|---------------------------|-------------------------|-------------------|-----------------------|-------------------|
| | 2015 | 2014 | 2015 | 2014 |
| Benefit obligation | \$(172,191) | \$(181,601) | \$(22,023) | \$(24,827) |
| Fair value of plan assets | 174,859 | 179,097 | — | — |
| Funded Status | \$ 2,668 | \$ (2,504) | \$(22,023) | \$(24,827) |

(In Thousands)

The funded status reconciles to amounts reported in the Statement of Admitted Assets, Liabilities, and Surplus as follows as of December 31:

| | Pension Benefits | | Other Benefits | |
|--|------------------|-------------------|-------------------|-------------------|
| | 2015 | 2014 | 2015 | 2014 |
| Prepaid pension asset (nonadmitted) | \$ 30,593 | \$ 27,993 | \$ — | \$ — |
| Accrued benefit cost and liability for benefits recognized (other liabilities) | (27,925) | (30,497) | (21,925) | (21,201) |
| | 2,668 | (2,504) | (21,925) | (21,201) |
| Unrecognized transition liability | — | — | (98) | (3,626) |
| Funded Status | \$ 2,668 | \$ (2,504) | \$(22,023) | \$(24,827) |

The breakout of the fair value of plan assets, projected benefit obligation and accumulated benefit obligation for plans in an overfunded status, where the fair value exceeded the projected benefit obligation, and plans in an underfunded status, where the projected benefit obligation exceeded the fair value of plan assets were as follows as of December 31:

| | Overfunded Pension Plans | | Underfunded Pension Plans | |
|--------------------------------|--------------------------|------------------|---------------------------|-------------------|
| | 2015 | 2014 | 2015 | 2014 |
| Projected benefit obligation | \$(144,266) | \$(151,104) | \$(27,925) | \$(30,497) |
| Fair value of plan assets | 174,859 | 179,097 | — | — |
| Funded Status | \$ 30,593 | \$ 27,993 | \$(27,925) | \$(30,497) |
| Accumulated benefit obligation | \$(144,266) | \$(151,104) | \$(27,925) | \$(30,497) |

SURPLUS ITEMS NOT YET RECOGNIZED The amounts in surplus that have not yet been recognized as part of net periodic benefit cost/(credit) were as follows as of December 31:

| | Pension Benefits | | Other Benefits | |
|---------------------------------|------------------|-----------------|----------------|----------------|
| | 2015 | 2014 | 2015 | 2014 |
| Unrecognized prior service cost | \$ — | \$ — | \$1,755 | \$1,754 |
| Unrecognized actuarial loss | 31,778 | 29,896 | 794 | 3,374 |
| Total | \$31,778 | \$29,896 | \$2,549 | \$5,128 |

The following represents activity relating to amounts recognized in surplus or included in the remaining unrecognized transition liability from the adoption of SSAP No. 92 during the year ended December 31, 2015 and 2014, including reclassification adjustments for those amounts recognized as components of net periodic benefit cost/(credit), for the years ended December 31:

| | Pension Benefits | | Other Benefits | |
|--|------------------|-----------------|-----------------|----------------|
| | 2015 | 2014 | 2015 | 2014 |
| Items not yet recognized as a component of net periodic benefit cost/(credit) — prior year | \$29,896 | \$ 5,369 | \$ 5,128 | \$5,619 |
| Net prior service cost arising during the period | — | — | — | — |
| Net prior service (cost)/credit recognized to net periodic benefit cost/(credit) | — | (15) | 1 | 1 |
| Net actuarial loss/(gain) arising during the period | 2,426 | 25,421 | (2,580) | (492) |
| Net actuarial (loss) recognized to net periodic benefit cost/(credit) | (544) | (879) | — | — |
| Items not yet recognized as a component of net periodic benefit cost — current year | \$31,778 | \$29,896 | \$ 2,549 | \$5,128 |

(In Thousands)

Amounts in surplus expected to be recognized as components of net periodic benefit cost/(credit) in 2016 are as follows:

| | Pension Benefits | Other Benefits |
|--|------------------|----------------|
| Amortization of net prior service credit | \$629 | \$(1) |
| Amortization of actuarial net loss | — | — |

NET PERIODIC BENEFIT COST/(CREDIT) The components of net periodic benefit cost/(credit) were as follows for the years ended December 31:

| | Pension Benefits | | Other Benefits | |
|---|-------------------|-------------------|----------------|----------------|
| | 2015 | 2014 | 2015 | 2014 |
| Service cost | \$ — | \$ — | \$ 416 | \$ 382 |
| Interest cost | 7,273 | 7,573 | 850 | 1,012 |
| Expected return on plan assets | (12,302) | (12,084) | — | — |
| Amortization of prior service cost/(credit) | — | 15 | (1) | (1) |
| Amortization of actuarial losses/(gains) | 544 | 879 | — | — |
| Total net periodic benefit (credit)/cost | \$ (4,485) | \$ (3,617) | \$1,265 | \$1,393 |

The weighted-average assumptions used to determine net periodic benefit cost/(credit) were as follows for the years ended December 31:

| | Pension Benefits | | Other Benefits | |
|--------------------------------|------------------|-------|----------------|-------|
| | 2015 | 2014 | 2015 | 2014 |
| Discount rate | 4.10% | 4.85% | 3.80% | 4.50% |
| Expected return on plan assets | 7.00% | 7.00% | N/A | N/A |
| Rate of compensation increase | N/A | N/A | N/A | N/A |

The assumed health care cost trend rates used in determining net periodic benefit cost were as follows for the years ended December 31:

| | 2015 | | 2014 | |
|---|--------|---------|--------|---------|
| | Pre-65 | Post-65 | Pre-65 | Post-65 |
| Health care cost trend rate assumed for next year | 7.45% | 6.75% | 7.75% | 7.00% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 5.00% | 5.00% | 5.00% | 5.00% |
| Year that the rate reaches the ultimate trend rate | 2022 | 2022 | 2022 | 2022 |

Assumed health care trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage point change in assumed health care cost trend rates would have the following effects:

| | One-Percentage Point | |
|--|----------------------|----------|
| | Increase | Decrease |
| Impact on total service and interest cost components | \$ 88 | \$(76) |
| Impact of postretirement benefit obligation | 1,287 | (1,144) |

(In Thousands)

ACTUAL CONTRIBUTIONS AND BENEFITS The contributions made and the benefits paid from the plans at December 31 were:

| | Pension Benefits | | Other Benefits | |
|------------------------|------------------|----------|----------------|----------|
| | 2015 | 2014 | 2015 | 2014 |
| Employer Contributions | \$ 2,569 | \$ 2,658 | \$ 1,490 | \$ 1,897 |
| Benefits Paid | (9,084) | (8,843) | (1,490) | (1,897) |

CASH FLOWS The Company's funding policy is to contribute an amount at least equal to the minimum required contribution under ERISA. The Company may increase its contribution above the minimum based upon an evaluation of the Company's tax and cash positions and the plan's funded status.

In 2016, the Company expects to make the minimum required contribution to the funded pension plan, currently estimated to be \$0. The Company expects to contribute to the unfunded pension and postretirement plans in amounts equal to the expected benefit costs of approximately \$2,699 and \$1,751, respectively.

The estimated future benefit payments are based on the same assumptions as used to measure the benefit obligations as of December 31, 2015 and 2014. The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| | Pension Plan Benefits | Other Post Retirement Plan Benefits |
|-----------------|-----------------------|-------------------------------------|
| 2016 | \$ 9,769 | \$ 1,751 |
| 2017 | 10,086 | 1,764 |
| 2018 | 10,404 | 1,752 |
| 2019 | 10,650 | 1,728 |
| 2020 | 10,764 | 1,698 |
| Years 2021-2025 | 54,789 | 8,026 |
| Total | \$106,462 | \$16,719 |

DEFINED CONTRIBUTION PLANS The Company maintains four defined contribution pension plans for substantially all of its employees and full-time agents. For two plans, designated contributions of up to 6% or 8% of annual compensation are eligible to be matched by the Company. Contributions for the third plan are based on tiered earnings of full-time agents. The last plan, which covers employees of a subsidiary, is determined on a discretionary basis by the Board of Managers of that subsidiary. For the years ended December 31, 2015, and 2014, the expense recognized for these plans was \$4,610 and \$6,252, respectively.

At December 31, 2015 and 2014, \$142,049 and \$138,333, respectively, of the defined contribution plans' assets were invested in the Company's group annuity contracts.

Note 9. FEDERAL INCOME TAXES

The Company follows Statement of Statutory Accounting Principles No. 101 – *Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10* (“SSAP 101”). SSAP 101 includes a calculation for the limitation of gross deferred tax assets for insurers that maintain a minimum of 300% of their authorized control level RBC computed without net deferred tax assets. The Company exceeded the 300% minimum RBC requirement at December 31, 2015 and 2014.

The Company is required to evaluate the recoverability of deferred tax assets and to establish a valuation allowance if necessary to reduce the deferred tax asset to an amount which is more likely than not to be realized. Considerable judgment is required in determining whether a valuation allowance is necessary, and if so, the amount of such valuation allowance. In evaluating the need for a valuation allowance, the Company considers many factors, including: (1) the nature of the deferred tax assets and liabilities; (2) whether they are ordinary or capital; (3) the

(In Thousands)

timing of their reversal; (4) taxable income in prior carryback years as well as projected taxable income exclusive of reversing temporary differences and carryforwards; (5) the length of time that carryovers can be utilized; (6) unique tax rules that would impact the utilization of the deferred tax assets; and (7) any tax planning strategies that the Company would employ to avoid a tax benefit from expiring unused; although the realization is not assured, management believes it is more likely than not that the deferred tax assets, net of valuation allowances, will be realized. The Company has not recorded a valuation allowance as of December 31, 2015 and 2014.

The components of deferred tax asset (DTAs) and deferred tax liabilities (DTLs) recognized by the Company are as follows as of December 31:

| Description | 2015 | | | 2014 | | |
|---|-------------------|-----------------|-------------------|-------------------|---------------|-------------------|
| | Ordinary | Capital | Total | Ordinary | Capital | Total |
| Gross deferred tax assets | \$ 440,023 | \$ 60,478 | \$ 500,501 | \$ 394,103 | \$ 33,710 | \$ 427,813 |
| Statutory valuation allowance adjustment | — | — | — | — | — | — |
| Adjusted gross deferred tax assets | 440,023 | 60,478 | 500,501 | 394,103 | 33,710 | 427,813 |
| Adjusted gross deferred tax assets nonadmitted | (118,039) | — | (118,039) | (94,522) | — | (94,522) |
| Subtotal — admitted adjusted deferred tax asset | 321,984 | 60,478 | 382,462 | 299,581 | 33,710 | 333,291 |
| Gross deferred tax liabilities | (93,950) | (57,833) | (151,783) | (70,315) | (32,825) | (103,140) |
| Net admitted deferred tax asset | \$ 228,034 | \$ 2,645 | \$ 230,679 | \$ 229,266 | \$ 885 | \$ 230,151 |

| Description | Changes during 2015 | | |
|---|---------------------|-----------------|---------------|
| | Ordinary | Capital | Total |
| Gross deferred tax assets/(liabilities) | \$ 45,920 | \$ 26,768 | \$ 72,688 |
| Statutory valuation allowance adjustment | — | — | — |
| Adjusted gross deferred tax assets | 45,920 | 26,768 | 72,688 |
| Adjusted gross deferred tax asset nonadmitted | (23,517) | — | (23,517) |
| Subtotal — admitted adjusted deferred tax asset | 22,403 | 26,768 | 49,171 |
| Gross deferred tax (liability)/asset | (23,635) | (25,008) | (48,643) |
| Net admitted deferred tax asset | \$ (1,232) | \$ 1,760 | \$ 528 |

(In Thousands)

Admitted DTA's are comprised of the following admission components based on paragraph 11 of SSAP No. 101 as of December 31:

| Description | 2015 | | | 2014 | | |
|---|------------------|-----------------|------------------|------------------|-----------------|------------------|
| | Ordinary | Capital | Total | Ordinary | Capital | Total |
| Federal income taxes paid in prior years recoverable through loss carrybacks | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — |
| Adjusted gross DTA expected to be realized (excluding the amount of DTA from above) after application of the threshold limitation (the lesser of 1 and 2 below) | 198,868 | 31,811 | 230,679 | 196,542 | 33,609 | 230,151 |
| 1. Adjusted gross DTA expected to be realized following the balance sheet date | 233,811 | 31,811 | 265,622 | 196,542 | 33,609 | 230,151 |
| 2. Adjusted gross DTA allowed per limitation threshold | | | 230,679 | — | — | 232,766 |
| Adjusted gross DTA (excluding the amount of DTA from above) offset by gross DTL | 123,116 | 28,667 | 151,783 | 103,039 | 101 | 103,140 |
| DTA admitted as the result of application of SSAP No.101 | \$321,984 | \$60,478 | \$382,462 | \$299,581 | \$33,710 | \$333,291 |

| Description | Changes during 2015 | | |
|--|---------------------|-----------------|-----------------|
| | Ordinary | Capital | Total |
| Federal income taxes paid in prior years recoverable through loss carrybacks | \$ — | \$ — | \$ — |
| Adjusted gross DTA expected to be realized (excluding the amount of DTA from above) after application of the threshold limitation (the lesser of 1 and 2 below)) | 2,326 | (1,798) | 528 |
| 1. Adjusted gross DTA expected to be realized following the balance sheet date | 37,269 | (1,798) | 35,471 |
| 2. Adjusted gross DTA allowed per limitation threshold | | | |
| Adjusted gross DTA (excluding the amount of DTA from above) offset by gross DTL | 20,077 | 28,566 | 48,643 |
| DTA admitted as the result of application of SSAP No. 101 | \$22,403 | \$26,768 | \$49,171 |

The authorized control level RBC and total adjusted capital computed without net deferred tax assets utilized when determining the amount of admissible net deferred tax assets was as follows:

| December 31 | 2015 | 2014 |
|---|-------------|-------------|
| Ratio percentage used to determine recovery period and threshold limitation amount | 539% | 573% |
| Amount of adjusted capital and surplus used to determine recovery period and threshold limitation | \$1,684,071 | \$1,684,153 |

(In Thousands)

The impact of tax planning strategies on the determination of adjusted gross DTA's and net admitted DTA's is as follows:

| December 31 | 2015 | | | 2014 | | | Change | | |
|--|----------|---------|-------|----------|---------|-------|----------|---------|-------|
| | Ordinary | Capital | Total | Ordinary | Capital | Total | Ordinary | Capital | Total |
| Adjusted gross DTA's | | | | | | | | | |
| Percentage of adjusted gross deferred tax assets attributable to the impact of tax planning strategies | 67% | 96% | 71% | 100% | 97% | 100% | (33)% | (1)% | (29)% |
| Net admitted DTA's | | | | | | | | | |
| Percentage for net admitted adjusted gross deferred tax assets admitted because of the impact of tax planning strategies | 81% | 100% | 83% | 100% | 100% | 100% | (19)% | —% | (17)% |

The Company's tax planning strategies do not include the use of reinsurance. There are no temporary differences for which a DTL has not been established.

Significant components of income taxes incurred

Current income taxes incurred consist of the following major components for the years ended December 31:

| Description | 2015 | 2014 |
|--|-------------------|-----------------|
| Current federal income tax expense/(benefit) | \$(33,190) | \$36,037 |
| Receivable adjustment per IRS audit | (2,023) | — |
| Federal income tax (benefit)/expense | (35,213) | 36,037 |
| Income tax effect on realized capital gains/(losses) | 26,710 | 30,405 |
| Federal and foreign income taxes incurred | \$ (8,503) | \$66,442 |

(In Thousands)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are as follows as of December 31:

| | 2015 | 2014 | Change |
|---|-------------------|-------------------|---------------|
| DTA resulting in book/tax difference in: | | | |
| Ordinary: | | | |
| Future policy benefits | \$ 45,412 | \$ 46,540 | \$ (1,128) |
| DAC | 101,039 | 95,503 | 5,536 |
| Dividend to policyholders | 16,800 | 14,420 | 2,380 |
| Deferred compensation | 35,228 | 33,821 | 1,407 |
| Nonadmitted assets | 18,224 | 17,944 | 280 |
| LIHTC credits | 33,872 | 25,216 | 8,656 |
| NOL Carryforward | 95,753 | 78,512 | 17,241 |
| Other- ordinary | 15,272 | 11,004 | 4,268 |
| Reinsurance transaction | 7,280 | — | 7,280 |
| Coinsurance transaction | 10,571 | 10,571 | — |
| PML Reserve Financing | 60,572 | 60,572 | — |
| Subtotal — Gross ordinary DTAs | 440,023 | 394,103 | 45,920 |
| Statutory valuation allowance adjustment — ordinary | — | — | — |
| Nonadmitted ordinary DTAs | (118,039) | (94,522) | (23,517) |
| Admitted ordinary DTAs | 321,984 | 299,581 | 22,403 |
| Capital: | | | |
| Investments | 4,594 | 1,162 | 3,432 |
| Net unrealized capital losses | 23,816 | — | 23,816 |
| OTTI on investments | 32,068 | 32,548 | (480) |
| Gross capital DTAs | 60,478 | 33,710 | 26,768 |
| Statutory valuation allowance adjustment — capital | — | — | — |
| Nonadmitted capital DTAs | — | — | — |
| Admitted capital DTAs | 60,478 | 33,710 | 26,768 |
| Admitted DTAs | 382,462 | 333,291 | 49,171 |
| DTLs resulting in book/tax differences in: | | | |
| Ordinary: | | | |
| Investments — ordinary | (82,684) | (60,000) | (22,684) |
| Other | (11,266) | (10,315) | (951) |
| Ordinary DTLs | (93,950) | (70,315) | (23,635) |
| Capital: | | | |
| Investments — capital | (26,547) | — | (26,547) |
| Alternative asset investments | (31,286) | (27,791) | (3,495) |
| Net unrealized capital gains | — | (5,034) | 5,034 |
| Capital DTLs | (57,833) | (32,825) | (25,008) |
| DTLs | (151,783) | (103,140) | (48,643) |
| Net deferred tax asset | \$ 230,679 | \$ 230,151 | \$ 528 |

(In Thousands)

The change in deferred income taxes, exclusive of the effect of nonadmitted assets, as the change in nonadmitted assets is reported separately from the change in net deferred income taxes in the Statements of Changes in Surplus, is comprised of the following:

| | 2015 | 2014 | Change |
|--|------------|------------|------------|
| Total deferred tax assets | \$ 500,501 | \$ 427,813 | \$ 72,338 |
| Total deferred tax liabilities | (151,783) | (103,140) | (48,643) |
| Net deferred tax asset | 348,718 | 324,673 | 23,695 |
| Statutory valuation allowance adjustment (“SVA”) | — | — | — |
| Net deferred tax asset/(liability) after SVA | 348,718 | 324,673 | 24,045 |
| Tax effect of net unrealized gains/(losses) | | | (28,850) |
| Tax effect of postretirement liability | | | (992) |
| Change in net deferred income tax | | | \$ (5,797) |

Reconciliation of Federal Income Tax Rate to Actual Effective Rate

The provision for federal income taxes incurred is different from that which would be obtained by applying the statutory federal income tax rate to income before income taxes. The significant items causing the differences as of December 31, 2015 are as follows:

| Description | Amount | Tax Effect | Effective Tax Rate |
|--|-----------|-------------------|--------------------|
| Income before taxes | \$102,447 | \$ 35,856 | 35.0% |
| Separate account dividend received deduction | (29,418) | (10,295) | (10.0)% |
| Dividends received deduction | (1,182) | (414) | (0.4)% |
| Meals and entertainment | 351 | 123 | 0.1% |
| Executive benefits | 4,612 | 1,614 | 1.6% |
| IMR tax adjustment | 1,728 | 605 | 0.6% |
| Income from affiliates | (60,702) | (21,246) | (20.7)% |
| LIHTC | | (8,652) | (8.4)% |
| Other | (849) | (297) | (0.4)% |
| Total | | \$ (2,706) | (2.6)% |
| Federal income taxes incurred | | \$ (8,503) | (8.3)% |
| Change in net deferred income tax | | 5,797 | 5.7% |
| Total Statutory Taxes | | \$ (2,706) | (2.6)% |

The effective tax rate is primarily driven by the following components: (1) the reversal of income from affiliates, the tax on which is recorded in their separate company financial statements, (2) the separate account dividends received deduction, and (3) low income housing tax credits.

In 2015, two Form 3115 “Application for Change in Accounting Methods” were filed with the IRS for the tax treatment of Indexed Universal Life and Variable Annuity hedging methodologies. Management believes they have made adequate provisions for these adjustments.

At December 31, 2015, the Company had \$273,580 of net operating loss carryforwards available that will begin to expire in 2026. In addition, the Company had LIHTC available of \$33,872 that will expire starting in 2030.

At December 31, 2015, the Company had no Alternative Minimum Tax (“AMT”) credit carryforwards.

There was no income tax expense for 2015, 2014 and 2013 that is available for recoupment in the event of future net losses.

(In Thousands)

The Company has not made any deposits regarding the suspension of running interest (protective deposits) pursuant to Internal Revenue Code Section 6603.

The Company's federal income tax return is consolidated with its majority owned subsidiaries. The method of tax allocation among the companies is subject to a written agreement, whereby the tax allocation is made on a benefits for loss basis. The tax share agreement allows for each direct Subsidiary of Parent that owns stock of another Subsidiary to be treated as the Intermediate Parent of the Intermediate Parent Group. As of December 31, 2015, only Penn Insurance and Annuity Company has elected to apply this clause of the tax sharing agreement.

A listing of the companies included in the consolidated return is as follows:

Penn Insurance & Annuity Company
PIA Reinsurance Company of Delaware I
Horner, Townsend & Kent, Inc.
HTK Insurance Agency, Inc.
Penn Mutual Asset Management, Inc.
Longevity Insurance Company, Inc.

The Internal Revenue Service ("IRS") has completed their examination of the Company's income tax returns through the year 2010. A limited scope audit for the years 2006-2010 was completed in 2015. Management believes they have adequately presented all adjustments. Tax years 2012 and subsequent are still subject to audit by the IRS.

The Company recognizes interest and penalties, if any related to unrecognized tax benefits, as a component of tax expense. During the years ended December 31, 2015 and 2014, the Company did not recognize or accrue penalties or interest.

The Company had no tax loss contingencies for which it is reasonably possible that the total liability will significantly increase within the next twelve months of the reporting date.

Note 10. REINSURANCE

The Company has assumed and ceded reinsurance on certain life and annuity contracts under various agreements. Reinsurance ceded permits recovery of a portion of losses from reinsurers.

The table below highlights the reinsurance amounts shown in the accompanying financial statements.

| | Gross Amount | Assumed | Ceded | Net Amount |
|---|-----------------|----------|-------------|---------------|
| December 31, 2015: | | | | |
| Premium and annuity considerations | \$1,803,531 | \$74,152 | \$ 681,398 | \$1,196,285 |
| Reserves and funds for payment of insurance and annuity benefits | 9,673,780 | 36,706 | 1,784,794 | 7,925,692 |
| December 31, 2014: | | | | |
| Premium and annuity considerations | \$1,617,182 | \$48,834 | \$1,002,010 | \$ 664,006 |
| Reserves and funds for payment of insurance and annuity benefits | 8,472,568 | 24,093 | 1,390,521 | 7,106,140 |

The Company has entered into an indemnity reinsurance agreement with a single non-affiliated reinsurer, whereby the Company cedes its risk associated with the Disability Income line of business. Under the agreement, 95% of the assets and liabilities were transferred to the reinsurer, and the assets were placed in a trust that names the Company as beneficiary. As of December 31, 2015 and 2014, the Company had a related reserve credit of \$191,425 and \$198,765, respectively, which was secured by investment grade securities with a market value of \$206,591 and \$237,522, respectively, held in trust.

(In Thousands)

The Company entered into a coinsurance agreement with an authorized, non-affiliated reinsurer, effective January 1, 2013, to coinsure an existing block of guaranteed term products issued from 2007 through 2012. The Company retains 20% of the risk while reinsuring the remaining 80%, up to excess retention, which is already reinsured through separate treaties. The Company transferred \$67,400 of reserves and \$23,300 in cash, and received a \$44,100 ceding commission. The after-tax gain of \$30,200 was a direct increase to surplus and will be amortized into income over the emerging earnings of the business. The Company did not recognize amortization of this gain for the years ended December 31, 2015 and 2014.

INTERCOMPANY REINSURANCE The Company maintains various reinsurance agreements with affiliates.

| | Affiliate | Assumed/(Ceded) | | | |
|----------------------------|-----------|-----------------|---------------|-------------|---------------|
| | | 2015 | | 2014 | |
| | | Premium | Reserves | Premium | Reserves |
| Coinsurance Funds Withheld | PIA | \$ (48,702) | \$ (942,839) | \$(849,045) | \$ (849,045) |
| IUL Inforce | PIA | (201,237) | (182,994) | — | — |
| Coinsurance | PIA | (134,135) | (428,233) | (37,764) | (338,684) |
| IUL | PIA | 67,281 | 33,641 | 41,977 | 20,988 |
| YRT — Over retention | PIA | 2,114 | 236 | 1,955 | 218 |
| Total | | \$(314,679) | \$(1,520,189) | \$(842,877) | \$(1,166,523) |

Coinsurance Funds Withheld At December 31, 2014, the Company entered into a contract to cede reserves pursuant to transactions subject to the requirements of Section 7 of the NAIC XXX and AXXX Reinsurance Model Regulation. The contract is a 70% coinsurance with funds withheld agreement with PIA effective December 31, 2014, to reinsure all risks related to an in-force block of single life no-lapse guaranteed universal life policies, net of inuring reinsurance, issued between October 2007 and June 2013 and inforce as of December 31, 2014. The policies are within the scope of the NAIC Valuation of Life Insurance Policies Model Regulation (“Regulation AXXX”). PIA contemporaneously reinsured the policies to PIA Reinsurance Company of Delaware I (“PIAre I”), an authorized, affiliated reinsurer.

The table below highlights the support for the Company reserve credit relating to its agreement with PIA, as well as the unamortized gain from the 2014 inforce transaction as of December 31:

| | 2015 | 2014 |
|----------------------------|-----------|-----------|
| Reserve Credit | \$942,840 | \$849,045 |
| Assets supporting reserve: | | |
| Primary Assets | 646,520 | 582,795 |
| Other Assets – PIAre I | 296,320 | 266,250 |
| Unamortized initial gain | 173,062 | 173,062 |

IUL Inforce Effective January 1, 2015, PML ceded to PIA an inforce block of single life index universal life policies issued by PML between 2012 and 2014. The Company ceded 100% of the risk, net of inuring reinsurance. The Company transferred \$113,021 of reserves and \$81,000 in securities, and received \$32,021 in ceding commission. The after-tax gain of \$20,814 was a direct increase to surplus and will be amortized into income over the emerging earnings of the business.

Coinsurance The Company cedes certain insurance risks to PIA on a coinsurance basis.

IUL The Company assumes the equity risk associated with PIA’s Indexed UL products on a YRT basis

YRT Over Retention The Company assumed from PIA policies issued after October 1, 2006 and before October 1, 2014 which resulted in retention greater than \$1,000 per life.

Note 11. RELATED PARTIES

The Company entered into revolving loan agreements with JMS on March 13, 2009 and January 15, 2010, to provide funding in an amount not to exceed \$65,000 and \$50,000, respectively. Terms of the loans specify that semi-annual interest be paid on the outstanding balances based on market rates determined at the dates of the loans. The principal balances are due to mature in January 2029 and March 2029, respectively.

The Company entered into revolving loan agreement with JMS on January 25, 2013, to provide funding in an amount not to exceed \$80,000. Terms of the loan specify the interest rate will be the published 3-Month Libor +250bps as of the draw date and will subsequently reset on the first business day of every fiscal quarter. The principal balance is due to mature in January 2033.

The Company recorded \$11,070 and \$10,911 in interest income on these notes for the years ended December 31, 2015 and 2014, respectively. At December 31, 2015 and 2014, the Company had outstanding principle receivables from JMS of \$165,000 and \$165,000 and interest receivables of \$2,797 and \$2,782, respectively, relating to these agreements.

The following table summarizes the gross, nonadmitted, and net admitted value of the Company's investment in SCA entities, segregated by line item classification within the Statements of Income:

| December 31 | 2015 | | | 2014 | | |
|---------------------------|-----------|-------------|--------------|-----------|-------------|--------------|
| | Gross | Nonadmitted | Net Admitted | Gross | Nonadmitted | Net Admitted |
| Common stock, affiliated: | | | | | | |
| PIA | \$363,063 | \$ — | \$363,063 | \$417,234 | \$ — | \$417,234 |
| HTK | 9,525 | — | 9,525 | 9,888 | — | 9,888 |
| PMAM | 1,608 | (1,608) | — | 891 | (891) | — |
| Subtotal | 374,196 | (1,608) | 372,588 | 428,013 | (891) | 427,122 |
| Other invested assets: | | | | | | |
| ISP | 201,389 | (13,268) | 188,121 | 188,397 | (13,225) | 175,172 |
| Total | \$575,585 | \$(14,876) | \$560,709 | \$616,410 | \$(14,116) | \$602,294 |

The Company files the non-insurance company SCAs of HTK, and PMAM with the NAIC SVO. The most recent filings for each of these SCAs were Sub-2 filings in June 2015. The NAIC Valuation method for both of these SCAs was 2ciB3 and no resubmissions were required. The NAIC Valuation amounts for these filings, which were as of December 31, 2014, were \$9,888 and \$0 for HTK and PML. The Company has filed the note receivables from JMS with the NAIC SVO and such notes have been designated with a rating of 3s.

The Company's unconsolidated subsidiaries had combined assets of \$8,809,606 and \$7,727,574 and combined liabilities of \$8,130,939 and \$7,025,582 as of December 31, 2015 and 2014, respectively. The admitted value of the Company's investments in subsidiaries includes goodwill of \$41,524 and \$41,371 and other intangible assets of \$3,204 and \$6,320 at December 31, 2015 and 2014, respectively.

During 2015 and 2014, the Company made capital contributions to ISP in the form of cash in the amount of \$16,721 and \$668, respectively.

Note 12. COMMITMENTS, CONTINGENCIES AND UNCERTAINTIES

LITIGATION The Company and its subsidiaries are involved in litigation arising in and out of the normal course of business, which seek both compensatory and punitive damages. In addition, the regulators within the insurance and brokerage industries continue to focus on market conduct and compliance issues. While the Company is not aware of any actions or allegations that should reasonably give rise to a material adverse impact to the Company's financial position or liquidity, the outcome of litigation cannot be foreseen with certainty.

In 2012, a putative class action complaint was filed against the Company in federal court alleging that the Company breached its contracts by failing to distribute surplus in excess of an alleged statutorily prescribed limit. After the complaint was filed, the Company moved to dismiss the complaint and plaintiffs opposed the Company's motion. The court decided the motion by abstaining from adjudicating the matter, ruling that the matter was one that should be decided by the Commonwealth of Pennsylvania Insurance Department. The action has been joined in the Insurance Department and the parties are presently conducting discovery. The Company believes that it has substantial defenses and will vigorously defend itself. No reasonable estimate can be made at this time regarding the potential liability, if any, or the amount or range of any loss that may result from this claim.

In December 2015, the New York State Department of Financial Services ("NY DFS") notified the Company that it did not agree with the reported calculation of statutory reserves for New York financial reporting purposes for certain universal life with secondary guarantee products. During February 2016, the Company reached an agreement with the NY DFS which will result in Penn Mutual holding additional statutory reserves on a New York basis. As of December 31, 2015, Penn Mutual held sufficient statutory surplus to satisfy these additional New York reserves, but such additional reserves will reduce New York statutory surplus. The company is not domiciled in New York, and these changes do not impact statutory reserves reported in our state of domicile, Pennsylvania, or any states other than New York, and therefore do not impact RBC ratios.

GUARANTY FUNDS The Company is subject to insurance guaranty fund laws in the states in which it does business. These laws assess insurance companies' amounts to be used to pay benefits to policyholders and policy claimants of insolvent insurance companies. Many states allow these assessments to be credited against future premium taxes. The liability for estimated guaranty fund assessments net of applicable premium tax credits as of December 31, 2015 and 2014 was \$375 and \$750, respectively. The Company monitors sales materials and compliance procedures and makes extensive efforts to minimize any potential liabilities in this area. The Company believes such assessments in excess of amounts accrued will not materially impact its financial statement position, results of operation, or liquidity.

LEASES The Company has entered into agreements to sell and subsequently leaseback certain assets. Computer equipment was sold for \$1,070 with two different leaseback arrangements of \$17 for 30 months and \$15 for 36 months. Furniture and equipment was sold for \$4,005 with a leaseback arrangement of \$72 for 60 months. At the end of the lease terms, the Company has the option to return the equipment, purchase it at fair value or extend the leases. The Company has also entered into other leases, primarily for field offices. As of December 31, 2015 future minimum payments under noncancellable leases are as follows:

| For the year ending: | |
|---------------------------------|----------|
| 2016 | \$12,094 |
| 2017 | 10,940 |
| 2018 | 8,078 |
| 2019 | 7,591 |
| 2020 | 6,423 |
| Thereafter | 20,352 |

Rent expense was \$17,524 and \$17,105 as of December 31, 2015 and 2014, respectively.

COMMITMENTS In the normal course of business, the Company extends commitments relating to its investment activities. As of December 31, 2015, the Company had outstanding commitments totaling \$346,001 relating to these investment activities. The fair value of these commitments approximates the face amount.

UNCLAIMED PROPERTY Significant attention has been focused on life insurance companies' processes and procedures used to identify unreported death claims and whether life insurance companies use the Social Security Master Death File ("SSMDF") to identify deceased policy and contract holders. The Company received notification from 14 states of their intent to examine compliance with their respective abandoned and unclaimed property acts. It is possible that other jurisdictions may pursue similar examinations. These actions may result in additional

payments to beneficiaries, additional escheatment of funds deemed abandoned under state laws, administrative penalties, interest, and/or further changes to the Company's procedures. While the Company is not currently able to estimate these additional possible costs, the Company does not believe they will have a material impact to its financial position or liquidity.

LOW INTEREST RATE ENVIRONMENT A period of sustained low interest rates could negatively impact the Company's profitability as the interest margin could decline. Declines in our interest margin or instances where the returns on our general account investments are not enough to support the interest rate guarantees could have a material adverse effect on our businesses or results of operations. The Company recognizes this risk and has been proactive in our investment strategies, product designs, crediting rate strategies and overall asset-liability practices to mitigate the risk of unfavorable consequences in this type of environment.

In periods when interest rates are declining or remain at low levels, we may have to reinvest the cash we receive as interest or return of principal on our investments in lower yielding instruments reducing our interest margin. Moreover, borrowers may prepay fixed-income securities and mortgage-backed securities in our general account in order to borrow at lower market rates, which exacerbates this risk. Lowering interest crediting rates helps to mitigate the effect of margin compression on some of our products. However, because many of our contracts have guaranteed minimum interest or crediting rates, our margin could still decrease and potentially become negative.

During period of low interest rates, policy reserves may not be sufficient to meet future obligations and may need to be strengthened, which would reduce net income in that reporting period. No additional policyholder reserves were established in 2015 or 2014 as a result of the low interest rate environment.

Note 13. DEBT

The Company has entered into repurchase agreements with financial institutions in the normal course of investment activities; however, there were no open positions as of December 31, 2015 and 2014.

Note 14. SUBSEQUENT EVENTS

On January 4, 2016, the Company and its funded defined benefit pension plan invested \$85,000 and \$15,000, respectively, in a private investment bond fund that is managed by PMAM.

The Company has evaluated events subsequent to December 31, 2015 and through the financial statement issuance date of February 16, 2016 and has determined that there were no significant events requiring recognition in the financial statements and no additional events requiring disclosure in the financial statements



Our Noble Purpose

Since 1847, Penn Mutual has been driven by our noble purpose – to create a world of possibilities, one individual, one family and one small business at a time. As an original pioneer of mutual life insurance in America, we believe that purchasing life insurance is the most protective, responsible and rewarding action a person can take to build a solid foundation today and create a brighter future for generations to come.